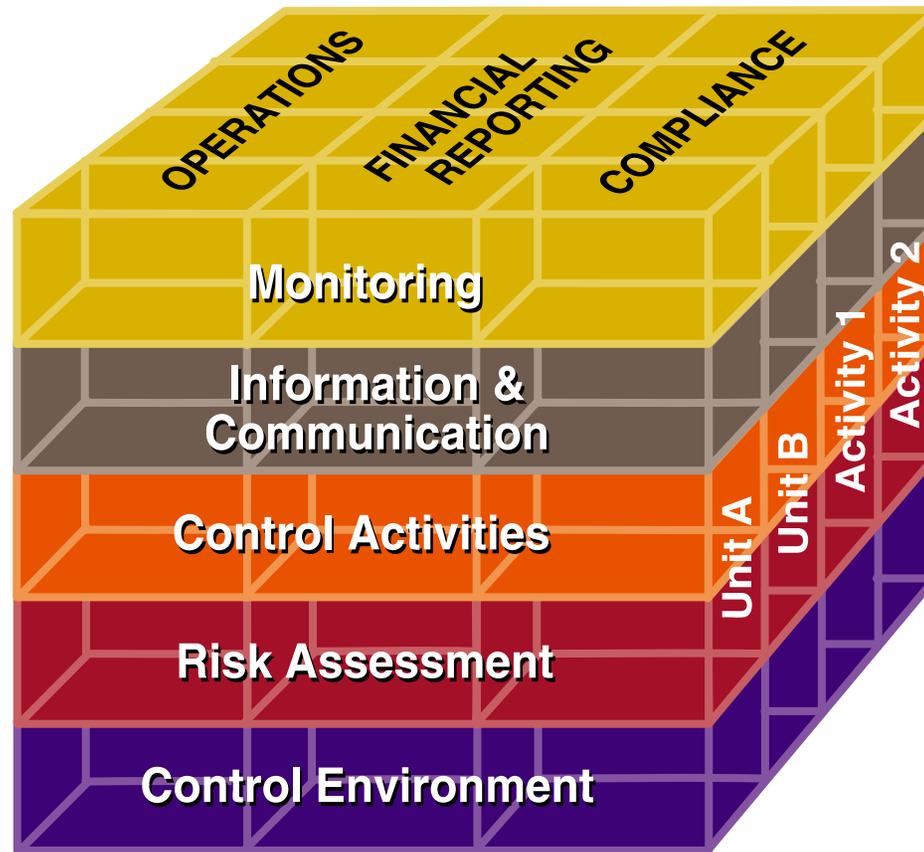


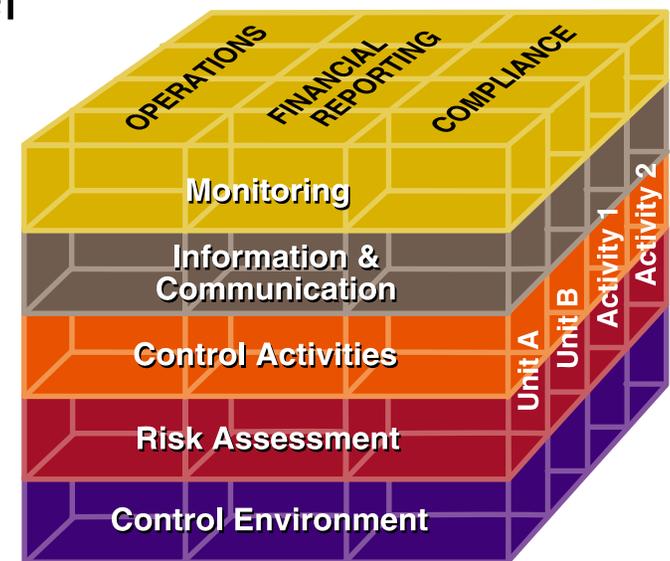
THE COSO INTEGRATED CONTROL CUBE



COSO Definition of Internal Control

“Internal control is a process, effected by an entity’s Board of Directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

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



Responsibility for Internal Control

- **Everyone in an organization has responsibility for internal control:**
 - ❖ Management: “Owns” internal control system and sets the Tone at the Top. Chief Executive Officer is ultimately responsible
 - ❖ Board of Directors/Audit Committee: Management is accountable to the Board, which provides governance, guidance and oversight
 - ❖ Internal Auditors: Evaluate the effectiveness of the internal control systems and contribute to ongoing effectiveness
 - ❖ Other personnel: Internal control is, to some degree, the responsibility of everyone in an organization

Responsibility for Internal Control, cont.

- External parties can contribute to internal control:
 - ❖ External auditors bring an independent and objective view, contributing directly through the financial statement audit and indirectly by providing information useful to management and the Board in executing their responsibilities
 - ❖ Legislators, regulators, customers, clients, financial analysts, news media and others provide information useful in effecting internal control
- However, external parties are not responsible for or a part of an entity's control system

Some Key Principles

- Control Environment – “Tone at the Top”
 - Develops, communicates, reinforces, and monitors integrity and ethical values within the organization and address any deviations
 - Importance of Board of Directors
 - ❑ Oversight responsibility for financial reporting and internal control
 - Management’s philosophy and operating style
 - Organizational structure
 - Commitment to competence
 - Authority and responsibility
 - Human Resources
 - ❑ Policies and practices should facilitate effective internal control

Some Key Principles, cont.

- Risk Assessment
 - Importance of financial reporting objectives
 - Identification and analysis of financial reporting risks
 - Assessment of fraud risk
 - Design risk response to reduce risk likelihood & impact to a level tolerable to management & the Board
- Control Activities
 - Elements of a control activity
 - ❑ Establishment and communication of policies and procedures throughout the entire organization
 - Control activities linked to risk assessment
 - Selection and development of control activities
 - ❑ Consideration of cost and potential effectiveness of mitigating risks
 - Information Technology
 - ❑ An enabler for effective internal control

Some Key Principles, cont.

- Information and Communication
 - Personnel clearly understand what constitutes acceptable & unacceptable behavior
 - There are open channels of communication between management & staff, including a mechanism for staff to report relevant issues without fear of reprisal
 - Open communications exist between senior management & the Board of Directors
 - Open communications exist between the entity & its clients or customers, providing a conduit for feedback
 - The entity complies with the requirements of external agencies, regulators, etc.

Some Key Principles, cont.

➤ Monitoring

- Ongoing monitoring
 - Performed in ordinary course of running the business
 - Performed on real-time basis and reacts to changing conditions
- Separate evaluations
 - Periodic testing, e.g., audits, process evaluations
- Includes process for reporting deficiencies
 - Should be identified and communicated in a timely manner to the appropriate parties so that corrective action can be taken and/or communicated to management and the Board

Primary Challenges to Implementing Effective Internal Control in Small Organizations

- ❖ Segregation of duties
- ❖ Management override
- ❖ Ineffective Board of Directors
- ❖ Qualified accounting personnel
- ❖ Information technology

Primary Challenges in Implementing Internal Control in Small Organizations, cont.

- Addressing Segregation of Duties challenge
 - ❖ Management should:
 - Ensure no one person can initiate, approve, receive, and disburse funds for any purchase
 - Ensure no one person can receive, post, deposit, and reconcile the bank account for any collections
 - Regularly review reports of detailed transactions on a timely basis to identify, investigate, and correct improper transactions
 - Periodically review sample transactions
 - Take periodic asset counts and compare to accounting records for assets such as inventory, equipment, and other tangible assets
 - Review budget analyses and cost trends to identify potential problem areas

Primary Challenges in Implementing Internal Control in Small Organizations, cont.

- Addressing Management Override challenge
 - ❖ Commitment to competence and strong ethical behavior, reinforced by the oversight of a quality independent Board
 - ❖ Effective whistle-blower program
 - ❖ Informed and inquisitive Audit Committee and Board of Directors
 - ❖ Independent audit
 - ❖ Internal audit

Primary Challenges in Implementing Internal Control in Small Organizations, cont.

- Addressing ineffective Board of Directors challenge
 - ❖ Broaden the pool of Board and Audit Committee members
 - ❖ Consider highly-qualified individuals with financial expertise to serve on Board and Audit Committee, such as:
 - ❑ Chief Financial Officers
 - ❑ Management Accounting experts
 - ❑ Accounting professors
 - ❑ Chief Audit Executives
 - ❑ Retired public accounting partners
 - ❖ Board members should always be objective and independent in performing their governance duties
 - ❖ Board members should maintain professional skepticism regarding management's representations, and should actively pursue clarification on matters they are uncertain of or uncomfortable with

Primary Challenges in Implementing Internal Control in Small Organizations, cont.

- Examples of Internal Control Circumvention
 - ❖ Collusion among management, employees, and/or third parties
 - ❖ Withheld, misrepresented, or falsified documentation
 - ❖ The ability of management to override, or instruct or coerce others to override, internal control policies and procedures
 - ❖ Responsibility for reviewing Board and employee expense accounts is assigned to personnel who lack sufficient expertise to evaluate the expenditures, and/or who lack sufficient authority to effectively challenge questionable expenditures

➤ **Be Proactive-An Internal Control Review is Strongly Recommended**

- ❖ Management and the Board should assess risk within the key financial processes of their organization:
 - Purchasing
 - Billings & Collections (including donations)
 - Asset Management
 - Payroll
 - Board & Employee Expense Accounts
 - Other significant financial processes related to the organization's specific charge, e.g., grant accounting
- ❖ Once assessed, the Board may wish to engage a CPA to conduct Agreed Upon Procedures examining the controls related to those key financial processes
 - The Board will need to consider costs vs. benefits when selecting Agreed Upon Procedures

➤ **SUMMARY**

- ❖ Strong internal controls are essential
- ❖ Tone at the top is critical
- ❖ Ethical business practices are essential
 - If the media reported on your organization's business practices, would you be proud or embarrassed?
 - Would your donors' trust be enhanced or eroded?
- ❖ Protect your organization's reputation
- ❖ Address internal control challenges proactively
 - Consider an Agreed Upon Procedures engagement

SOURCES:

- Committee of Sponsoring Organizations of the Treadway Commission (COSO)
- Crowe Horwath LLP