

## Overview:

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) updated the Internal Control Framework in 2013. They added 17 new principles and 87 focus points to assist senior management and executives in creating an effective internal control system. The Green Book, which is the standards for Internal Control in the Federal Government, was revised in 2014 by adapting the updates released by COSO and presenting them in a governmental language.

The first component of the framework is Control Environment.

**Control Environment** is the foundation of an internal control system. It is the set of standards, policies and processes which provides the discipline and structure which affect the quality of the internal control system. It influences how objectives are defined and how control activities are structured. The oversight body and management establish and maintain an environment throughout the entity that sets a positive attitude toward internal control.

The Control Environment component contains five principles, and to help management and the oversight body achieve each principle, there are attributes pertaining to each of the five principles.

### **Principle 1- Commitment to Integrity and Ethical Values:**

“The oversight body and management should demonstrate a commitment to integrity and ethical values.”

#### **Attributes:**

- Tone at the top
- Standards of conduct
- Adherence to standards of conduct

#### **Tone at the top:**

The oversight body and management must set the tone at the top by leading by example and demonstrate the importance of integrity and ethical values through their guidance and behavior. The oversight body and management, through their commitment to doing what is right, sets an example to all stakeholders, such as regulators, employees, and contractors. With a strong tone at the top, the oversight body and management’s vision to objective setting, risk identification, and risk response will be in line with the organization’s mission statement.

#### **Standards of Conduct:**

The oversight body and management establish standards of conduct to communicate expectations concerning ethical values and behaviors to stakeholders including employees, regulators and contractors. They also establish guidelines, policies, and procedures to communicate standards of conduct throughout the organization.

### **Adherence to Standards of Conduct:**

The oversight body and management should evaluate adherence to standards of conduct and address any deviation in a timely manner. They must use the standards and policies as a basis to evaluate adherence to integrity and ethical values, and the evaluation must be across all levels of the entity. The oversight body and management should determine the level of tolerance, when deviation from standards occurs. The level of tolerance may vary based on the severity of deviation from zero tolerance in some instances to a formal conversation, a warning, or more in other instances.

### **Principle 2- Exercise Oversight Responsibility:**

“The oversight body should oversee the entity’s control system.”

### **Attributes:**

- Oversight structure
- Oversight for the internal control system
- Input for remediation of deficiencies

### **Oversight Structure:**

The entity selects the oversight body and determines the structure necessary (unless otherwise mandated by law) to fulfil its responsibilities. The oversight body will be the Executive Leadership Team. An oversight body oversees the entity’s operations, provides constructive criticism to management, and where appropriate, makes oversight decisions so that the entity achieves its objectives in alignment with the entity’s integrity and ethical values.

The oversight body members should have certain expertise and capabilities including integrity and ethical values. They should also have certain specialized skills like internal control mindset, financial, technological, programmatic expertise, and legal and regulatory skills. An oversight body containing skills such as these, they should be able to address or solve any issues the entity may face.

Members of an oversight body scrutinize and question management’s activities, present alternative views, and act when faced with obvious or suspected wrongdoing. Independent members with relevant expertise provide value through their impartial evaluation of the entity and its operations in achieving objectives.

### **Oversight the internal control system:**

The oversight body oversees management’s design, implementation, and operation of the entity’s internal control system including all five components (Control Environment, Risk assessment, Control activities, information and communication, and monitoring). The oversight body oversees management’s design, implementation, and operation of the entity’s organizational structure so that the processes necessary to enable the oversight body to fulfill its responsibilities exist and are operating effectively.

### **Input for remediation of deficiencies:**

The oversight body provides input to management's plans for remediation of deficiencies in the internal control system as appropriate. When management reports deficiencies to the oversight body, they provide directions to remediate these deficiencies identified by management. The oversight body is responsible for overseeing the remediation of deficiencies as appropriate and for providing direction to management on appropriate time frames for correcting these deficiencies.

### **Principle 3- Establish Structure, Responsibility, and Authority:**

"Management should establish an organizational structure, assign responsibility, and delegate authority to achieve the entity's objectives."

#### **Attributes:**

- Organizational structure
- Assignment of responsibility and delegation of authority
- Documentation of the internal control system

#### **Organizational Structure:**

Management establishes an organizational structure necessary to execute the entity's objectives. Management should keep in mind the entity's objectives while establishing the organizational structure. Management should assign certain responsibilities to different divisions, and determine if the current structure provides for efficient and effective operation, correcting as necessary.

Management also establishes lines of communications between the entity's divisions to be able to communicate any issues effectively so they can execute the entity's objectives. Management should evaluate the organizational structure periodically, to make sure it is in accordance with the entity's objectives and has adapted to any new objectives for the entity, such as a new law or regulation.

#### **Assignment of Responsibility and Delegation of Authority:**

Responsibilities should be assigned to management and those in key roles, which in turn can be delegated downstream, but management should retain full ownership of the function of the unit. Generally, key roles relate to senior management positions within an entity. Those in key roles can further assign responsibility for internal control to roles below them in the organizational structure, but retain ownership for fulfilling the overall responsibilities assigned to the unit.

Management determines what level of authority each key role needs to fulfill a responsibility. Management delegates authority only to the extent required to achieve the entity's objectives. As part of delegating authority, management evaluates the delegation for proper segregation of duties within the unit and in the organizational structure. Segregation of duties helps prevent fraud, waste, and abuse in the entity by considering the need to separate authority, custody, and accounting in the organizational structure.

### **Documentation of Internal Control System:**

Management develops and maintains documentation of its internal control system. Effective documentation assists management's design of the internal control system by establishing and communicating the who, what, when, where, and why of internal control execution to personnel.

Management documents internal control to meet operational needs. Documentation of controls, including changes to controls, is evidence that controls are identified, capable of being communicated to those responsible for their performance, and capable of being monitored and evaluated by the entity.

The extent of documentation needed to support the design, implementation, and operating effectiveness of the five components of internal control is a matter of judgment for management. Management considers the cost benefit of documentation requirements for the entity as well as the size, nature, and complexity of the entity and its objectives.

### **Principle 4- Demonstrate Commitment to Competence:**

"Management should demonstrate a commitment to recruit, develop, and retain competent individuals."

#### **Attributes:**

- Expectations of competence
- Recruitment, development, and retention of individuals
- Succession and contingency plans and preparation

#### **Expectations of Competence:**

Competence is the qualifications required to perform assigned responsibilities. It requires relevant knowledge, skills, and abilities, which are gained largely from professional experience, training, and certifications. Management should determine the expectations of competence for personnel. Management acts as necessary to address any deviations from the established policies.

Management considers standards of conduct, assigned responsibility, and delegated authority when establishing expectations. Personnel need to possess and maintain a level of competence that allows them to accomplish their assigned responsibilities, as well as understand the importance of effective internal control. The oversight body evaluates the competence of management as well as the overall competence of entity personnel.

#### **Recruitment, Development, and Retention of Individuals:**

Having competent and knowledgeable personnel is very important in each entity. Management should develop procedures to attract and recruit those types of individuals. Management should train those individuals regularly on any changes or updates that may occur, and offer specialized training tailored around their assigned responsibilities.

Mentoring personnel and addressing any issues they may have is a key function of management's role, and is providing guidance on their performance in relation to policies and procedure.

In order to retain employees, management should provide incentive to motivate employees and reinforce the expected level of performance.

- **Recruit** - Conduct procedures to determine whether a particular candidate fits the organizational needs and has the competence for the proposed role.
- **Train** - Enable individuals to develop competencies appropriate for key roles, reinforce standards of conduct, and tailor training based on the needs of the role.
- **Mentor** - Provide guidance on the individual's performance based on standards of conduct and expectations of competence, align the individual's skills and expertise with the entity's objectives, and help personnel adapt to an evolving environment.
- **Retain** - Provide incentives to motivate and reinforce expected levels of performance and desired conduct, including training and credentialing as appropriate.

### **Succession and Contingency Plans and Preparation:**

Management defines succession and contingency plans for key roles to help the entity continue achieving its objectives. Succession plans address the entity's need to replace competent personnel over the long term, whereas contingency plans address the entity's need to respond to sudden personnel changes that could compromise the internal control system. Management also should be ready in case of a sudden vacancy created by the departure of key personnel which may compromise the integrity of the internal control system.

Management defines succession plans for key roles, chooses succession candidates, and trains succession candidates to assume the key roles. Management defines contingency plans for assigning responsibilities if a key role in the entity is vacated without advance notice. The importance of the key role in the internal control system and the impact to the entity of its vacancy dictates the formality and depth of the contingency plan. Similar planning should be conducted for contractors.

### **Principle 5- Enforce Accountability:**

"Management should evaluate performance and hold individuals accountable for their control responsibilities."

#### **Attributes:**

- Enforcement of accountability
- Consideration of excessive pressures

#### **Enforcement of Accountability:**

Management enforces accountability of individuals performing their internal control responsibilities. Accountability is driven by the tone at the top and supported by the commitment to integrity and ethical

values, organizational structure, and expectations of competence, which influence the control culture of the entity.

Management holds entity personnel accountable for performing their assigned internal control responsibilities. The oversight body, in turn, holds management accountable as well as the organization as a whole for its internal control responsibilities.

If management establishes incentives, management recognizes that such actions can yield unintended consequences and evaluates incentives so that they align with the entity's standards of conduct.

If the entity utilizes contractors, they should communicate the entity's objectives and related risks to contractors. They also should hold the contractor accountable for their assigned responsibilities.

Management, with oversight from the oversight body, takes corrective action as necessary to enforce accountability for internal control in the entity. These actions can range from informal feedback provided by the direct supervisor to disciplinary action taken by the oversight body, depending on the significance of the deficiency to the internal control system.

### **Consideration of Excessive pressures:**

Excessive pressure occurs in the entity when management assigns unrealistic or unachievable goals and responsibilities or increases the workload on the employees. Excessive pressure may cause employees to cut corners to achieve their goals or even engage in fraudulent activities.

Management is responsible to evaluate their employees' workload and understand pressures. Once management recognizes excessive pressure, they should adjust the work load or increase the resource levels.