

# Internal Control Concepts & Applications

*Presented by:*

Syracuse University Office of Audit  
& Management Advisory Services  
(AMAS)

# Internal Control

Today when we talk about internal control, we're talking about a new standard.

- Promulgated by the Committee of Sponsoring Organizations (COSO), also known as the Treadway Commission
- COSO is causing a paradigm shift where the emphasis is on identification and management of business risks

# COSO Model of Internal Control

A means to help organizations build in a process to manage business risks

- promotes building controls in business processes
- Emphasizes the importance of people
- Expands definition of Internal Control beyond financial accounting controls and procedures
- Promotes achievement of business objectives
- Emphasizes that control is *everybody's* job

# Roles and Responsibilities

Virtually all employees play some role in affecting control. All personnel should be responsible to communicate:

- problems in operations
- deviations from established standards
- violations of policy or law

# Roles and Responsibilities

An organization's leaders are ultimately responsible and must assume "ownership" of the internal control system for their areas of responsibility.

This responsibility is then delegated throughout the organization's "Chain of Command"

# Roles and Responsibilities

- The Chancellor provides leadership and direction to senior administrators
- Vice Presidents provide direction to deans and department heads
- Deans and department heads have line responsibility for designing and implementing control systems at detailed levels

# Definition of Internal Control

Internal control is a process effected by a college or university's governing board, administration, faculty and staff designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

# Internal Control Objectives

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



# Definition of Internal Control

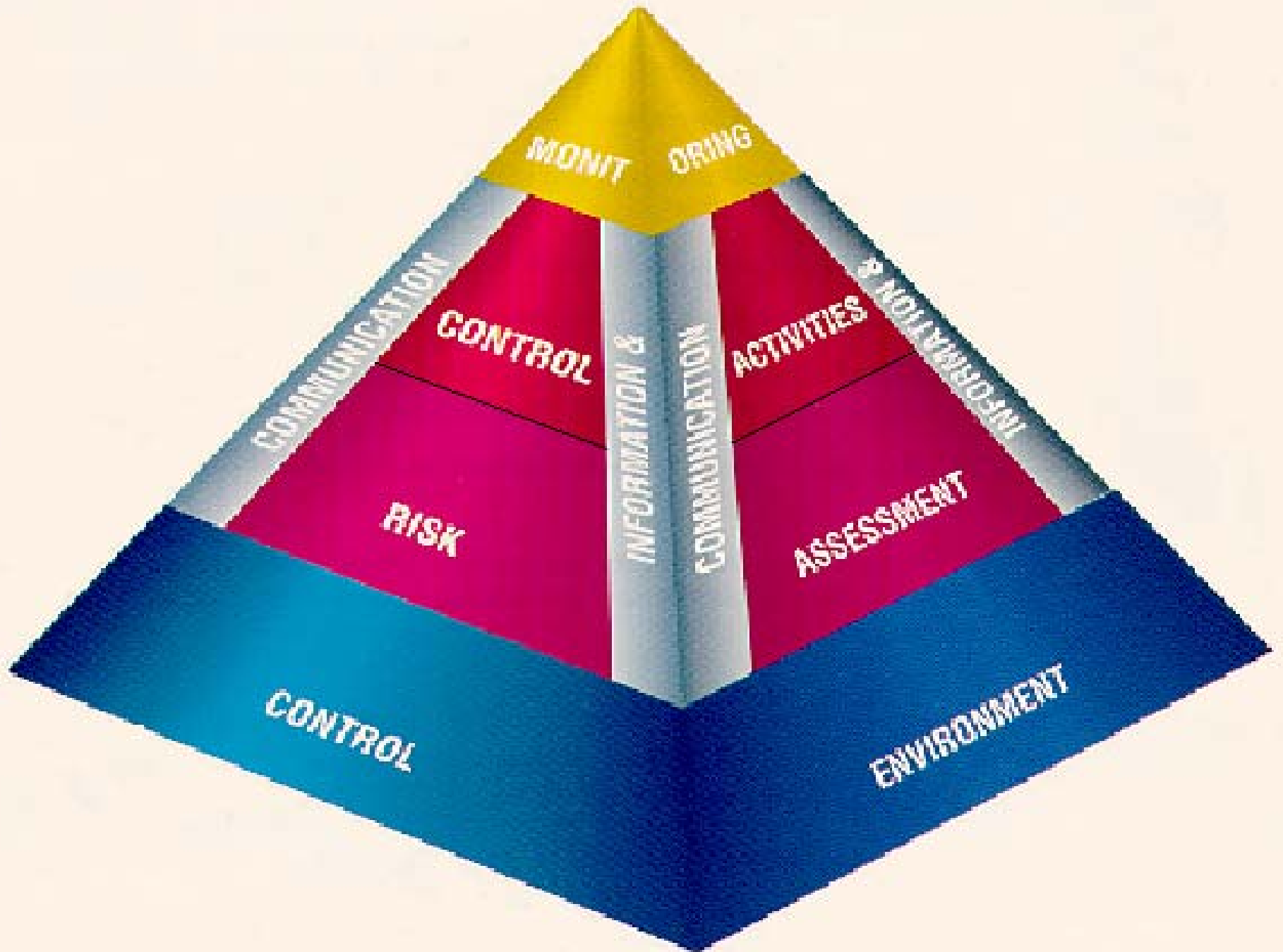
Fundamental concepts:

- Internal control is a process
- Internal control is effected by people
- Internal control is geared to the achievement of objectives
- Internal control cannot be expected to provide absolute assurance of the achievement of objectives

# Components of Internal Control

Internal control consists of five interrelated components:

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



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# Control Environment

Foundation for the control environment:

- Senior management sets the tone
- Establishment of an institutional culture
- Based on attitudes and practices of those in positions of authority
- Influences the “control consciousness” of everyone in the organization

# Control Environment

Control factors include:

- Integrity and ethical values
- The competence of an institution's people
- Leadership philosophy & operating style
- The way management assigns authority and responsibility and organizes and develops its people

# Control Environment

Integrity and ethical values.

An institution's objectives and how they are achieved are based on preferences, value judgments and management styles. Those preferences and value judgments, when translated into standards of behavior, reflect leaders' integrity and their commitment to ethical values.

# Control Environment

SU's control environment begins with:

- Mission Statement



# SU Mission Statement

“To promote learning through teaching, research, scholarship, creative accomplishment, and service.”

# Control Environment

SU's control environment begins with:

- Mission Statement
- Vision Statement

# SU Vision Statement

- To be the leading student-centered research university
- Where its core values are pervasive among all its members
- That attracts & retains superior and diverse faculty & staff
- Where the campus is safe, secure, well-maintained and readily accessible
- With a sound fiscal position where resources are allocated consistent with SU's mission & vision

# Control Environment

SU's control environment begins with:

- Mission Statement
- Vision Statement
- Core Values

# SU Core Values

Quality

Caring

Innovation

Service

*Diversity*

# Control Environment

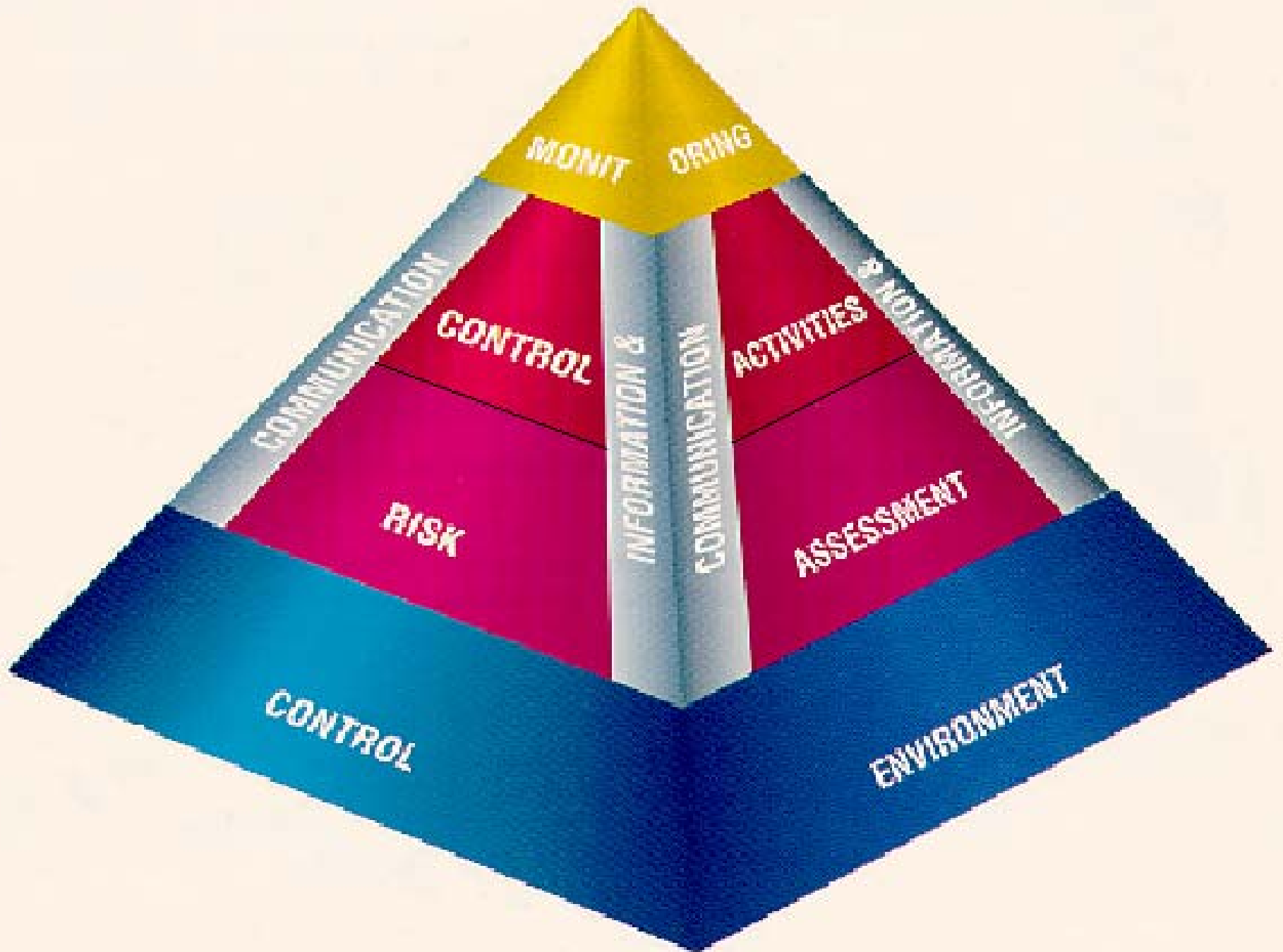
The following examples of weaknesses in the integrity of the control environment can create temptations for otherwise honest employees:

- Nonexistent or ineffective controls
- High decentralization & a weak reporting system
- Penalties for improper behavior that are insignificant or unpublished

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# Risk Assessment

Failure to adequately identify and address important risks can have a significant negative impact on:

Product or service quality

- Financial strength
- Public image or reputation

# Risk Assessment

## Basic Assumptions:

- No practical way to reduce risks to zero
- Managing in a changing environment requires a constant assessment of risk and the impact on internal controls
- A precondition to risk assessment is establishment of institutional, divisional and unit-specific objectives

# Risk Assessment

Risk assessment is the identification & analysis of relevant risks to achievement of specific objectives:

- Operations objectives
- Financial reporting/accountability objectives
- Compliance objectives

# Risk Assessment

## Risk Assessment Activities:

- Identify risks relative to each objective
- Evaluate the significance/priority of risks
- Assess the likelihood risk occurrence
- Decide how much risk is acceptable
- Consider how to manage each risk, including costs

# Risk Assessment

## Risk Factors - External Sources

- Economic changes
- Changing student & community needs or expectations
- New or changed legislation / regulations
- Technological developments
- Natural catastrophes

# Risk Assessment

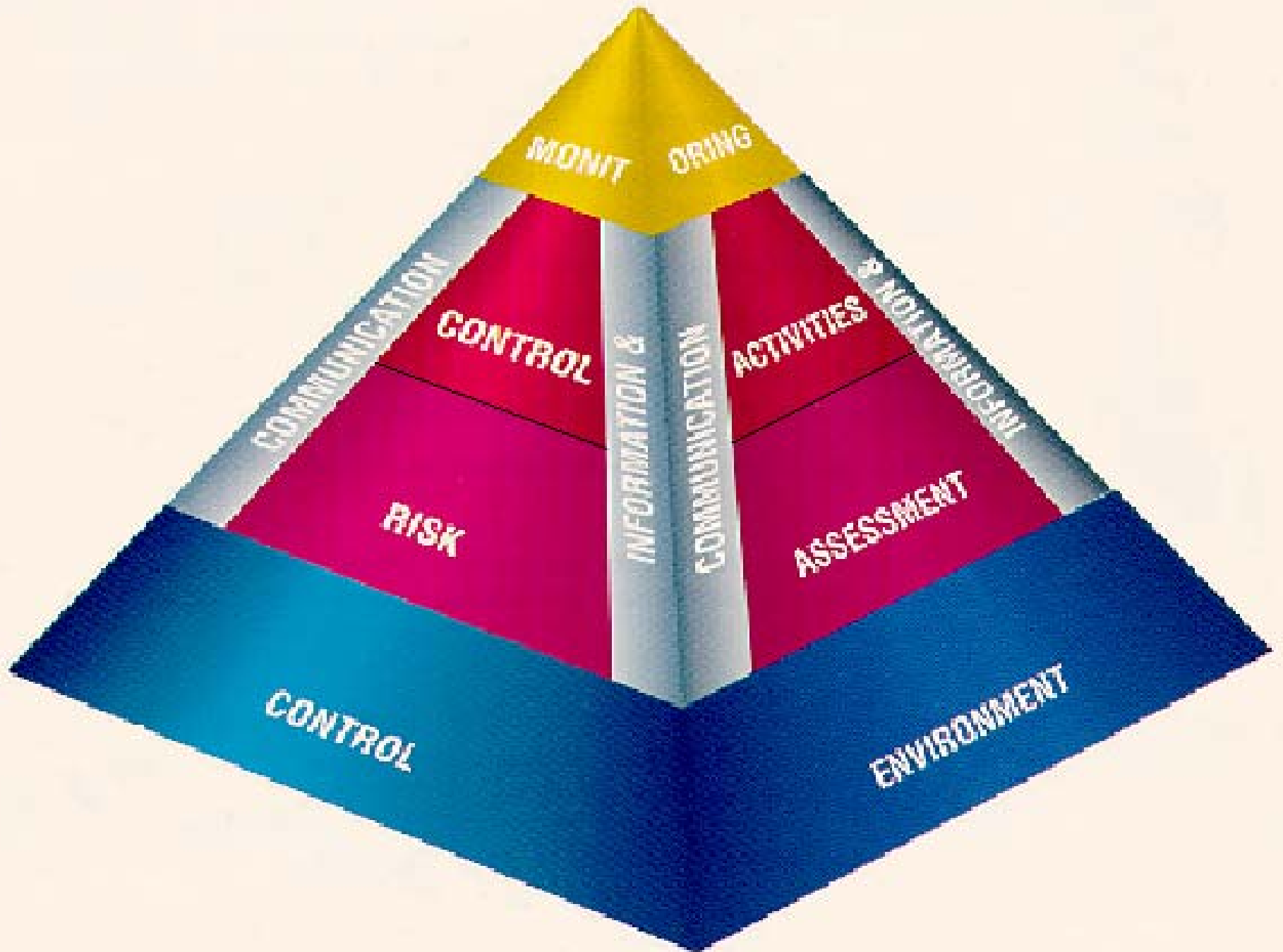
## Risk Factors - Internal Sources

- New personnel
- New or revamped information systems
- Changes in management responsibilities
- New or changed educational or research programs
- Low morale

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# Control Activities

- Control activities are the specific policies & procedures designed to mitigate risks
- They occur at all levels & in all functions throughout the institution.

# Control Activities

## Policies & Procedures

- Policy establishes what should be done. It can be communicated orally or established formally in writing.
- Procedures effect implementation of the policy.
- All policies must be implemented thoughtfully & consistently.

# Control Activities

## Types of Control Activities

- Performance reviews
  - Achievement of Objectives
  - Actual vs. budget comparison
  - Indicators (i.e.. statistics, surveys)

# Control Activities

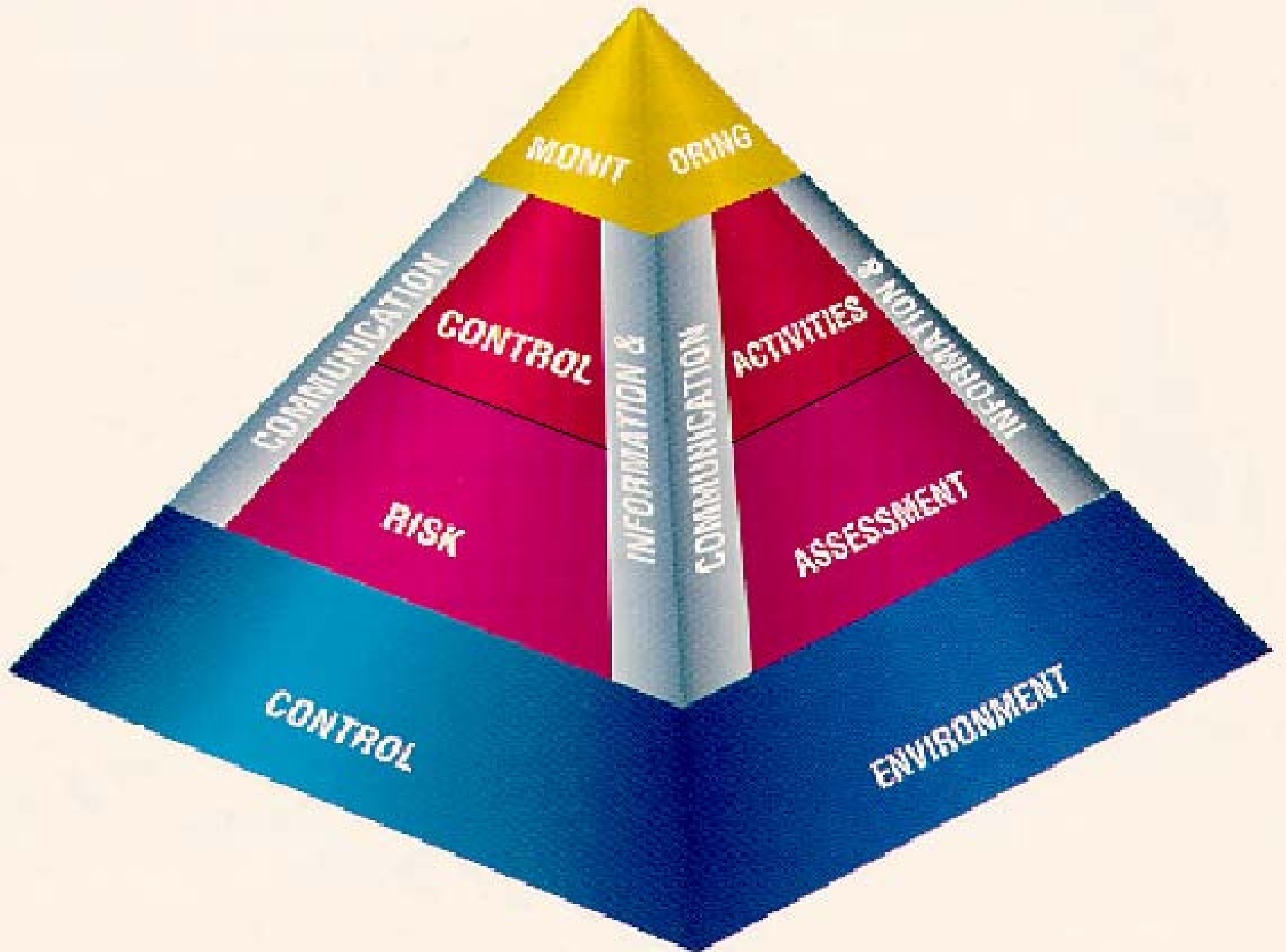
## Types of Control Activities

- Performance reviews
- Direct functional or activity management
- Information processing
- Physical controls
- Segregation of duties

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# Information & Communication

Pertinent information relative to the internal control environment must be identified, captured and communicated to appropriate personnel on a timely basis.

# Information & Communication

Effective communication must occur:

- Flowing down the organization
- Flowing across the organization
- Flowing up the organization



# Information & Communication

Effective information systems must:

- Be based on a strategic plan, congruent with objectives
- Have necessary resources committed
- Reach the right people
- Contain detailed and timely information
- Be accurate and reliable

# Information & Communication

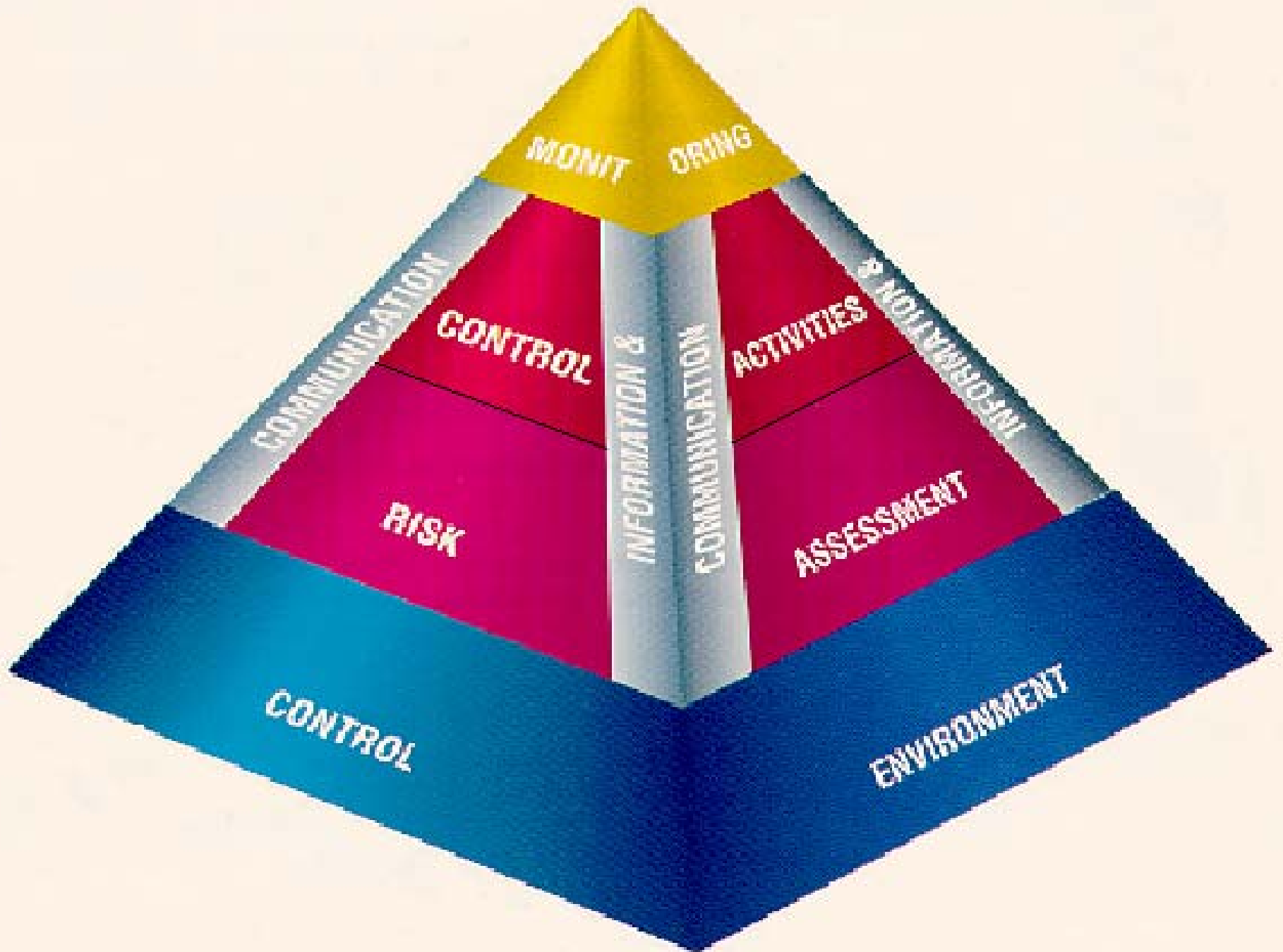
Effective Communication depends on:

- Employees aware of their control duties
- Ways to report suspected improprieties
- Openness to employees' suggestions
- Communication across departments
- Awareness of institution's standards
- Appropriate follow-up to info. feedback

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# Monitoring

Continuous monitoring of the system of internal control assesses the quality of the system's performance over time.

- Minimizes surprises
- Should be on-going
- Self-assessment
- External reviews

# Monitoring

“Ongoing” monitoring activities:

- Review of operating & financial reports for inaccuracies or exceptions
- Investigation of info from external parties which may indicate problems
- Supervisory oversight of control functions & identification of deficiencies
- Comparison of data records with physical assets

# Monitoring

“Ongoing” monitoring activities (cont.):

- Feedback to management concerning the effectiveness of internal controls
- Routine assessment of controls by internal and external auditors
- Periodic confirmation that personnel understand & comply with the institution's code of conduct

# Monitoring

“Separate” internal control evaluations can be conducted by:

- Management
- Internal or external auditors
- Specialized groups (i.e., consultants)



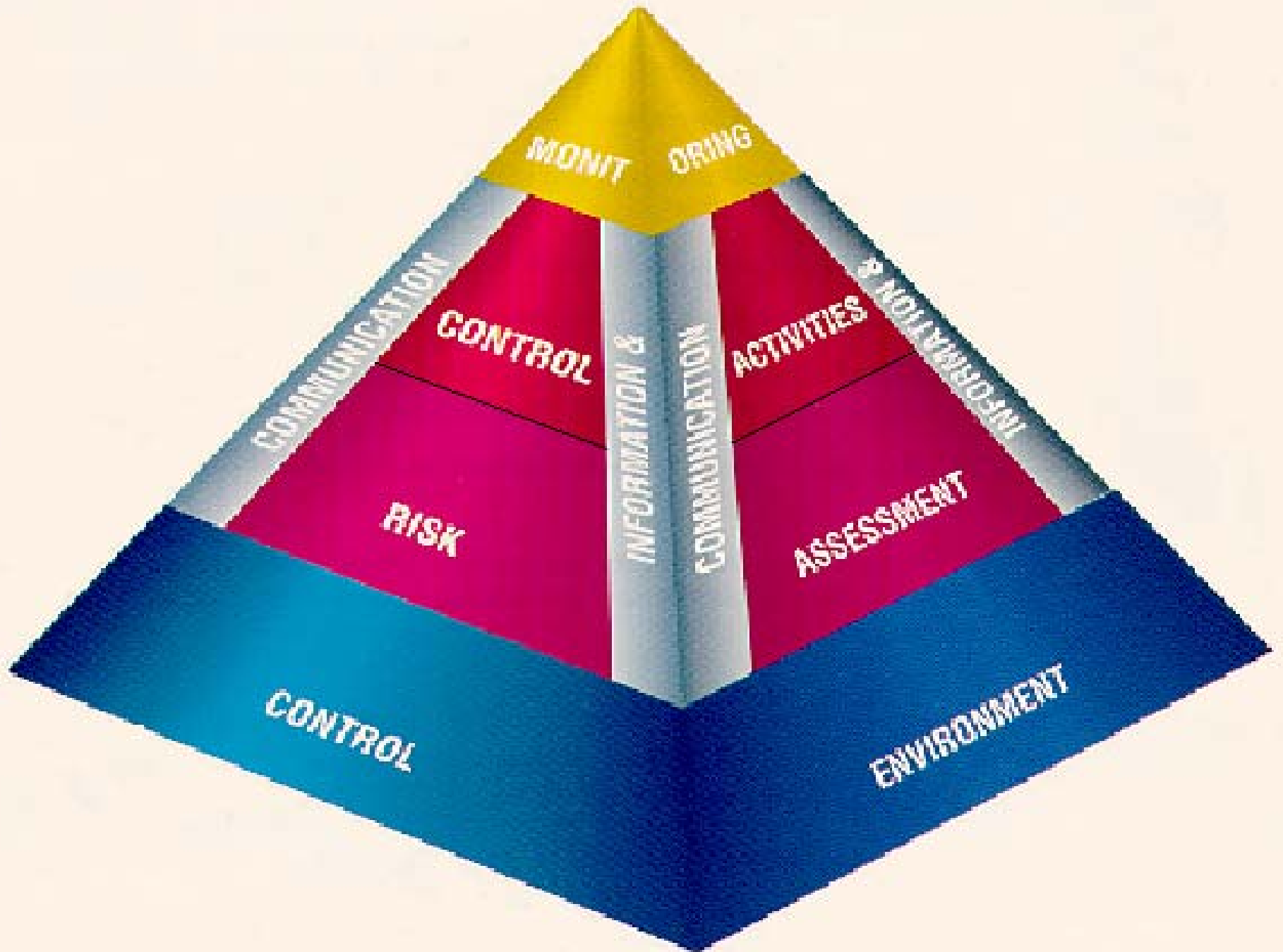
# Monitoring

Reporting Deficiencies in the internal control environment:

- The appropriate people must be informed
- Establish reporting protocols

# Limitations of Internal Control

- Poor Judgment
- Breakdowns
- Management override
- Collusion
- Excessive costs relative to benefits



# The End

Thank you for viewing this presentation on the COSO model of internal control.

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