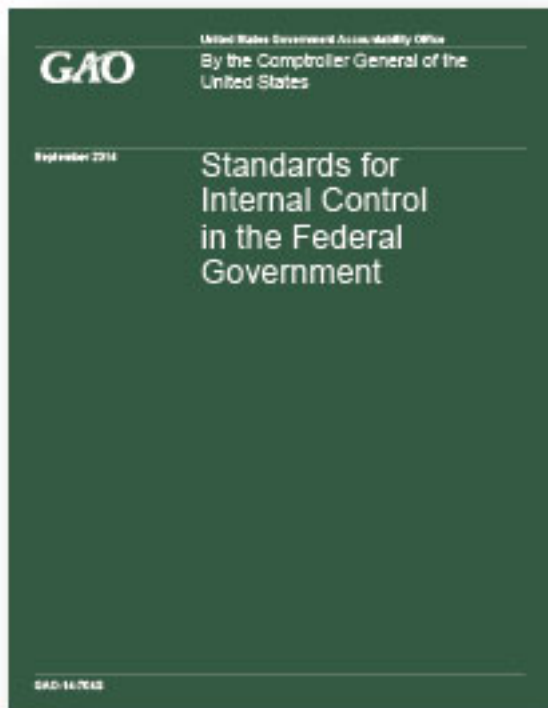


Green Book Training: Internal Control for Auditors



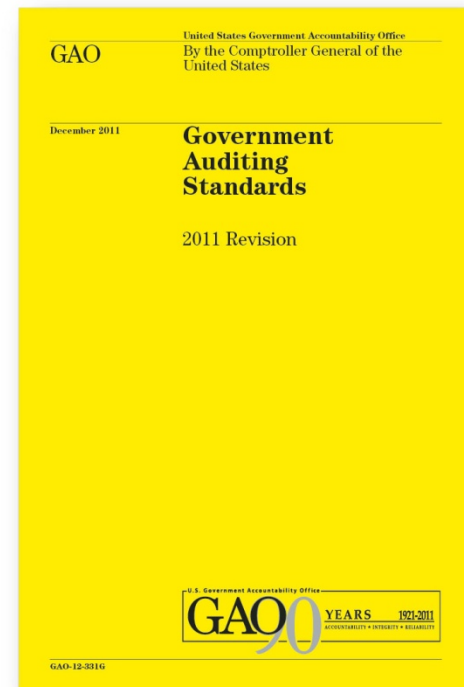
Source: GAO.

Green Book and Yellow Book



Source: GAO.

- Condition
- Criteria
- Cause
- Effect



Source: GAO.

Agenda

Introduction and Course Objectives	5 minutes
Module 1: Introduction to Internal Control	45 minutes
Module 2: Components of Internal Control	
Break	15 minutes
Module 2: Case Study	50 minutes

Course Objectives

At the end of this course, participants will be able to:

- Demonstrate a fundamental understanding of internal control, based on the 2014 Green Book.
- Describe the five components of internal control and the principles and critical concepts for each component.
- Apply internal control concepts to the audit engagement, using the Green Book.

Module 1: Introduction to Internal Control

- **Background**
 - Internal control and objectives
 - Users of the Green Book
 - Internal control through the years
 - Statutory authority
 - The 2014 Green Book

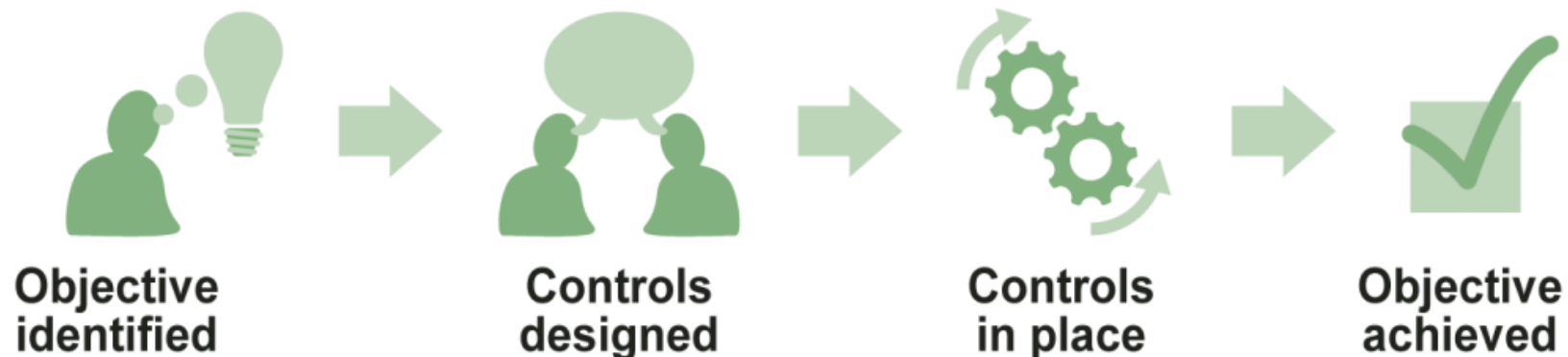
- **Fundamental concepts of internal control**
 - Definitions
 - ☐ Internal control
 - ☐ Internal control system
 - The internal control cube
 - ☐ Objectives
 - ☐ Components
 - ☐ Organizational structure

Module 1: Introduction to Internal Control (cont.)

- **The structure of the Green Book**
 - Components
 - Principles
 - Attributes
 - Internal control requirements

Module 1: Introduction to Internal Control

Internal Control and Objectives



Source: GAO. | GAO-14-704G

Put simply, internal control is a process used by management to help an entity achieve its objectives.

Module 1: Introduction to Internal Control

Internal Control and Objectives (cont.)

Objectives

=

What is to be accomplished?

Strategic goals

**Purpose of
the program**

**Operational
process**

Quarterly internal report

Module 1: Introduction to Internal Control

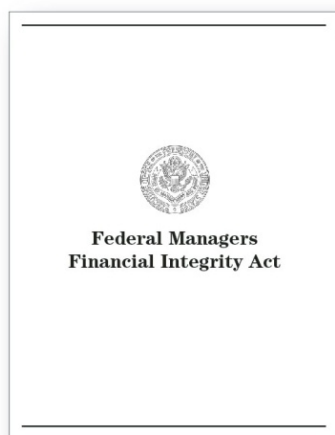
Users of the Green Book

Examples of who would use the Green Book:

- A program manager at a federal agency
- Inspector general staff conducting a performance audit or financial audit engagement
- A compliance officer responsible for overseeing and managing regulatory compliance issues
- Grant recipient personnel responsible for managing awarded funds

Module 1: Introduction to Internal Control

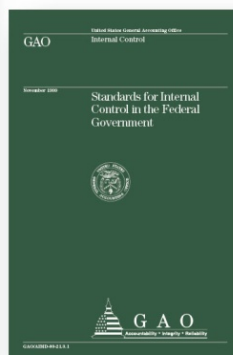
Internal Control through the Years



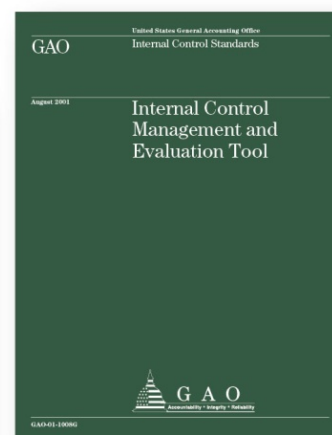
1982
FMFIA



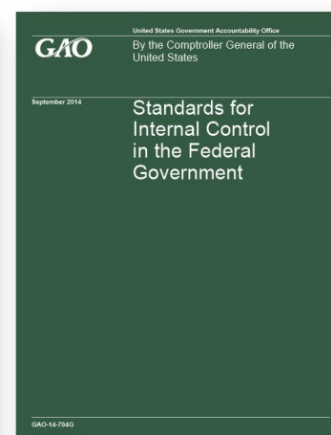
1983
First Green
Book



1999
First
revision



2001
Tool



2014
Current
revision

Source: GAO.

Module 1: Introduction to Internal Control

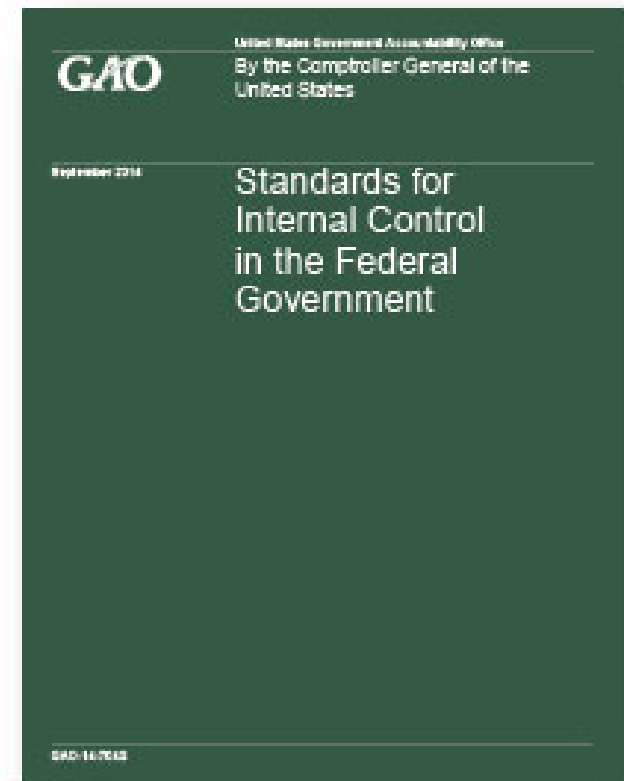
Statutory Authority

- Per the Federal Managers' Financial Integrity Act of 1982 (FMFIA), GAO is required to set the *Standards for Internal Control in the Federal Government* (Green Book).
- Per FMFIA, the Office of Management and Budget (OMB) is required to issue evaluation guidance (Circular A-123, *Management's Responsibility for Internal Control*).
- Auditors may use the Green Book as criteria to evaluate the design, implementation, and operating effectiveness of an entity's internal control system.

Module 1: Introduction to Internal Control

The 2014 Green Book

- All requirements from the 1999 Green Book have been incorporated in the 2014 revision.
- The 2014 revision provides more detail of the requirements to help management better understand and implement the standards.
- The 2014 revision will be effective beginning with fiscal year 2016 and the Federal Managers' Financial Integrity Act (FMFIA) reports covering that year. Management, at its discretion, may elect early adoption of the 2014 Green Book.



Source: GAO.

Module 1: Introduction to Internal Control

Definitions

Internal Control

- “Internal control is a process effected by an entity’s oversight body, management, and other personnel that provides reasonable assurance that the objectives of an entity will be achieved.” (Para. OV1.01)

Module 1: Introduction to Internal Control

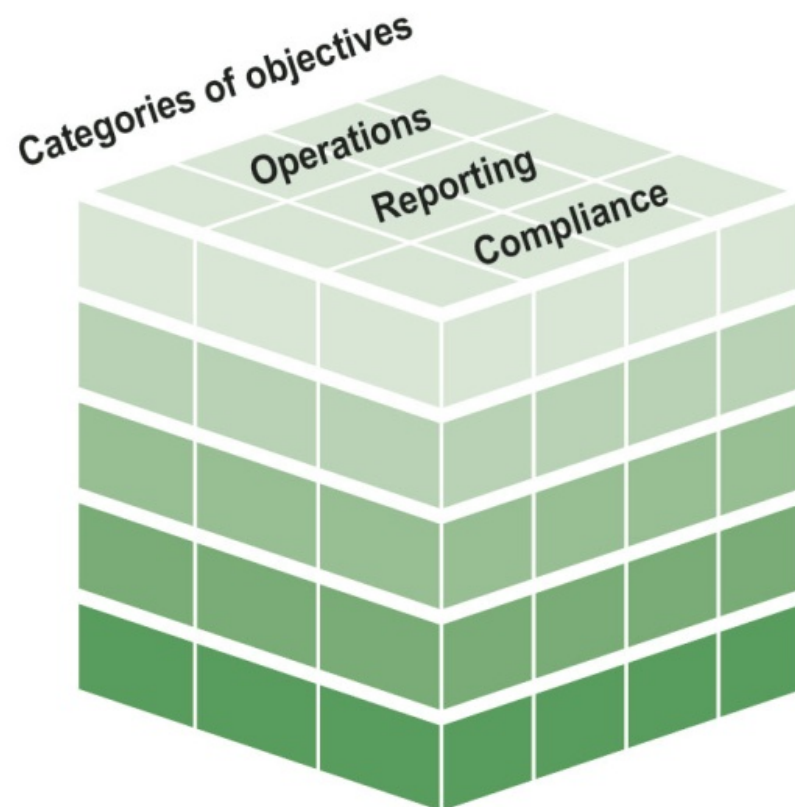
Definitions

Internal Control System

- “An internal control system is a continuous built-in component of operations, effected by people, that provides reasonable assurance, not absolute assurance, that an entity’s objectives will be achieved.” (Para. OV1.04)

Module 1: Introduction to Internal Control

The Internal Control Cube



Sources: COSO and GAO.

Module 1: Introduction to Internal Control

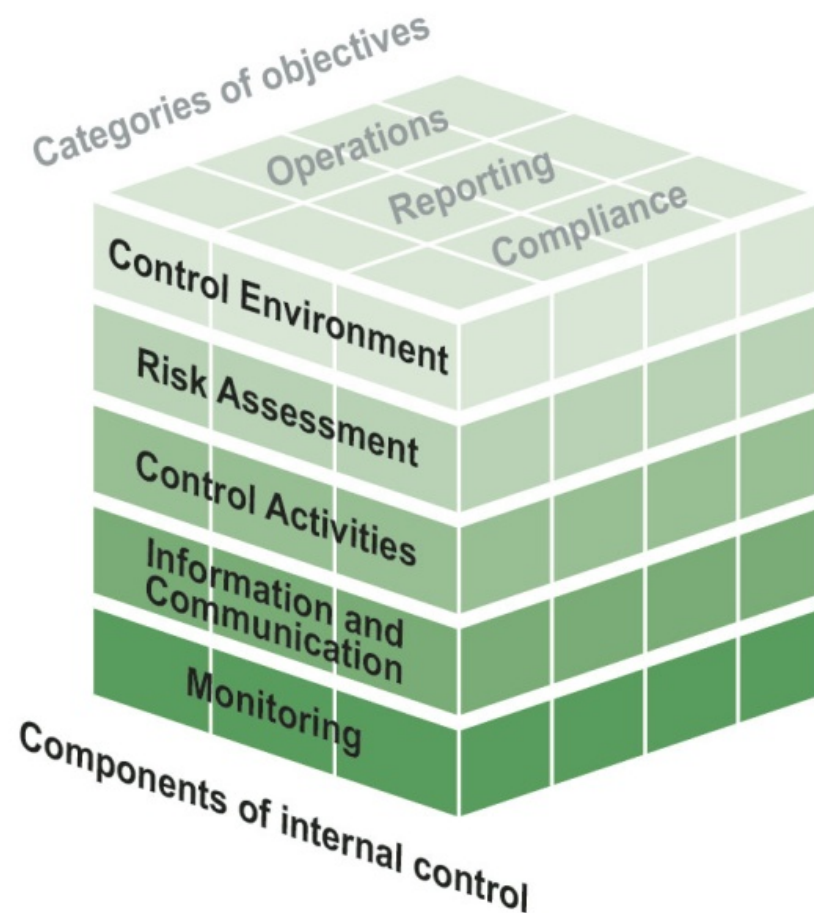
Types of Objectives

Management groups objectives into one or more of the following three categories (Para. OV2.18):

- **Operations** - Effectiveness and efficiency of operations (Para. OV2.19)
- **Reporting** - Reliability of reporting for internal and external use (Para. OV2.21)
- **Compliance** - Compliance with applicable laws and regulations (Para. OV2.22)

Module 1: Introduction to Internal Control

The Internal Control Cube (cont.)



Sources: COSO and GAO.

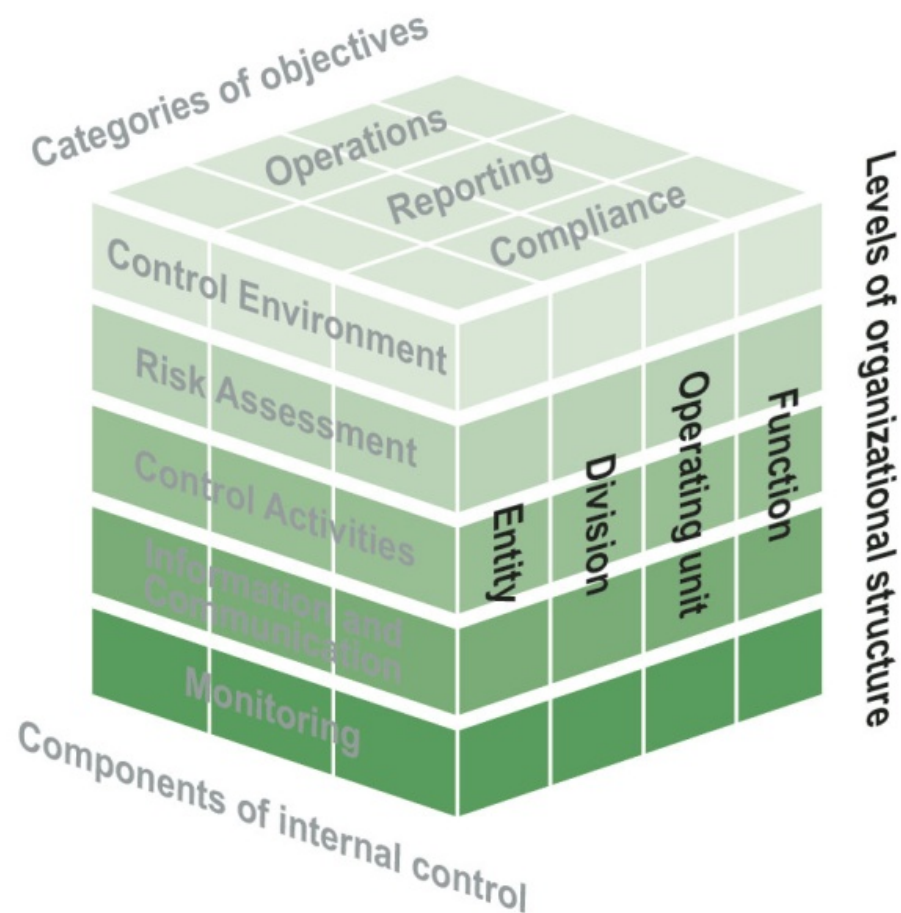
Module 1: Introduction to Internal Control

The Five Components

- Five Components of Internal Control (Para. OV2.04)
 - Control Environment
 - Risk Assessment
 - Control Activities
 - Information and Communication
 - Monitoring

Module 1: Introduction to Internal Control

The Internal Control Cube (cont.)

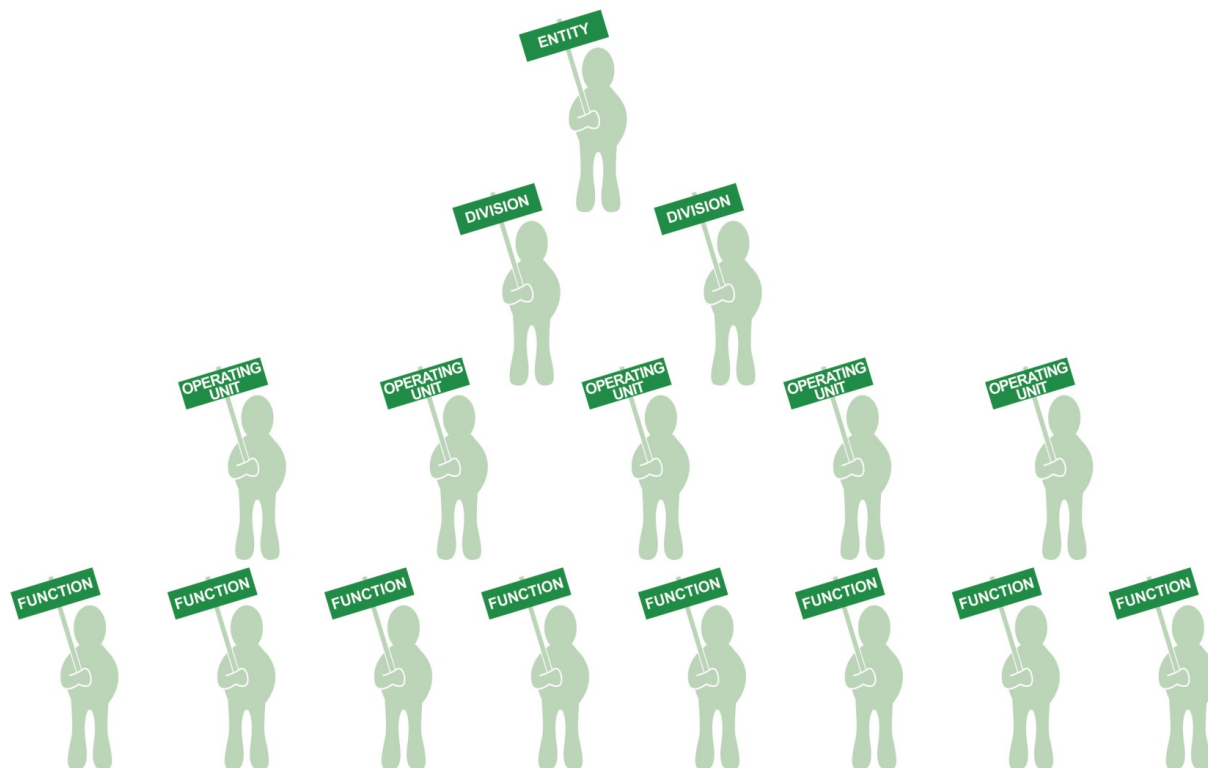


Sources: COSO and GAO.

Module 1: Introduction to Internal Control

Organizational Structure

Organizational Structure encompasses the operating units, operational processes, and other structures management uses to achieve the objectives. (Para. OV2.10)



Source: GAO.

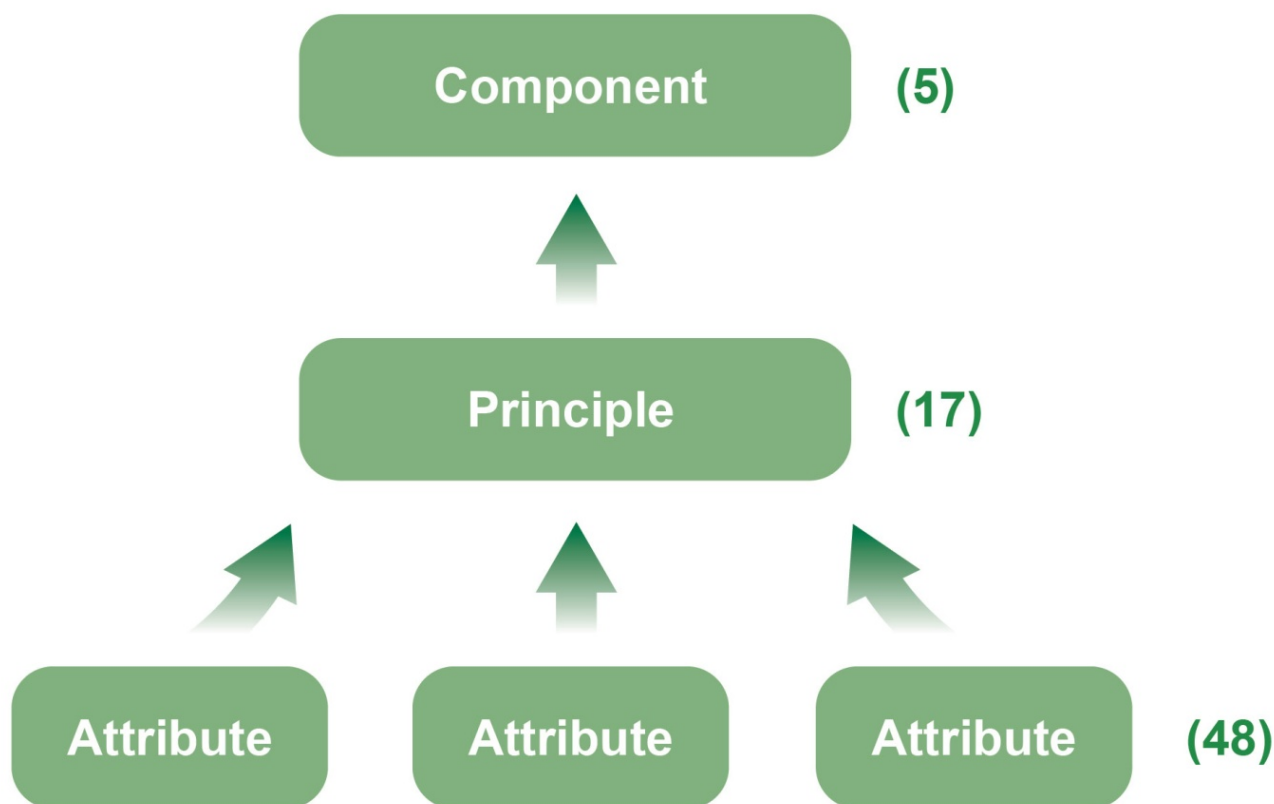
Module 1: Introduction to Internal Control

Group Exercise (Matching)

- Potential Issues
 - A. Agency does not consider how external parties will use its reports
 - B. No actions designed by agency to achieve mandated objective
 - C. The agency does not have a key role filled in its organizational structure
- Components:
 - 1. Control Environment
 - 2. Risk Assessment
 - 3. Control Activities
 - 4. Information and Communication
 - 5. Monitoring

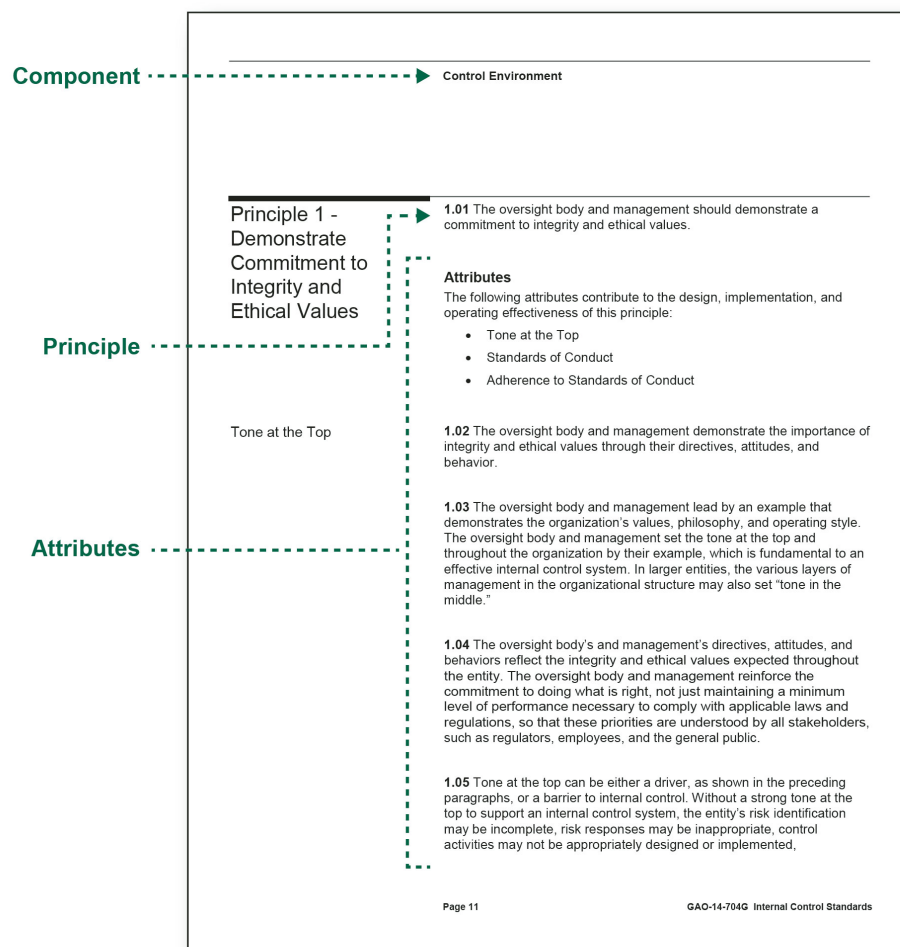
Module 1: Introduction to Internal Control

The Structure of the Green Book



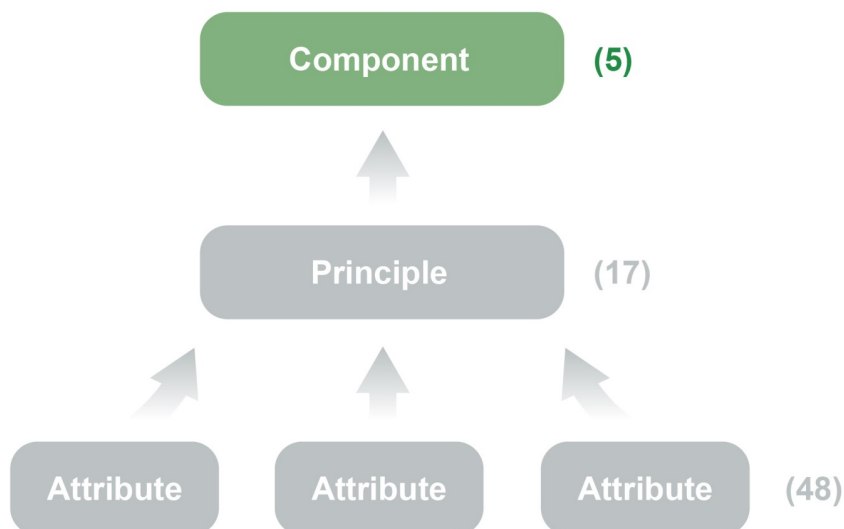
Module 1: Introduction to Internal Control

Green Book Sample Page



Module 1: Introduction to Internal Control Components

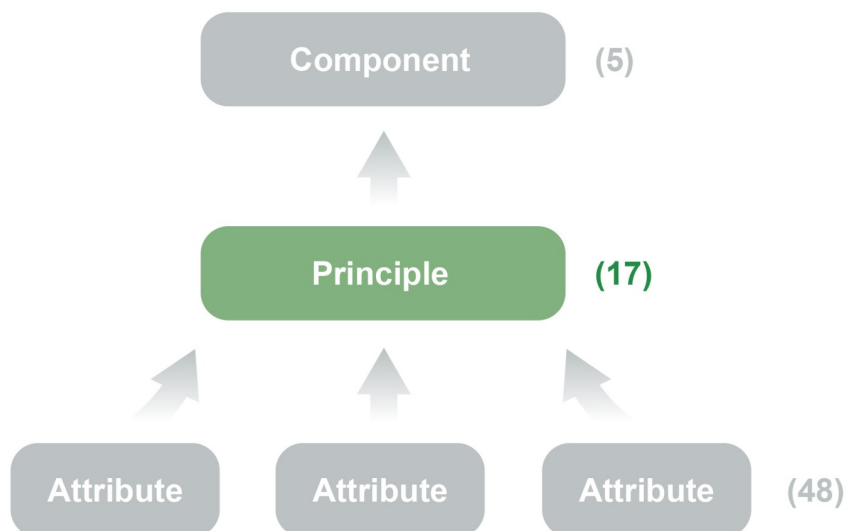
Components - The five components represent the highest level of the hierarchy of standards for internal control in the federal government and must be effectively designed, implemented, and operating together in an integrated manner, for an internal control system to be effective. (Para. OV2.04)



Source: GAO.

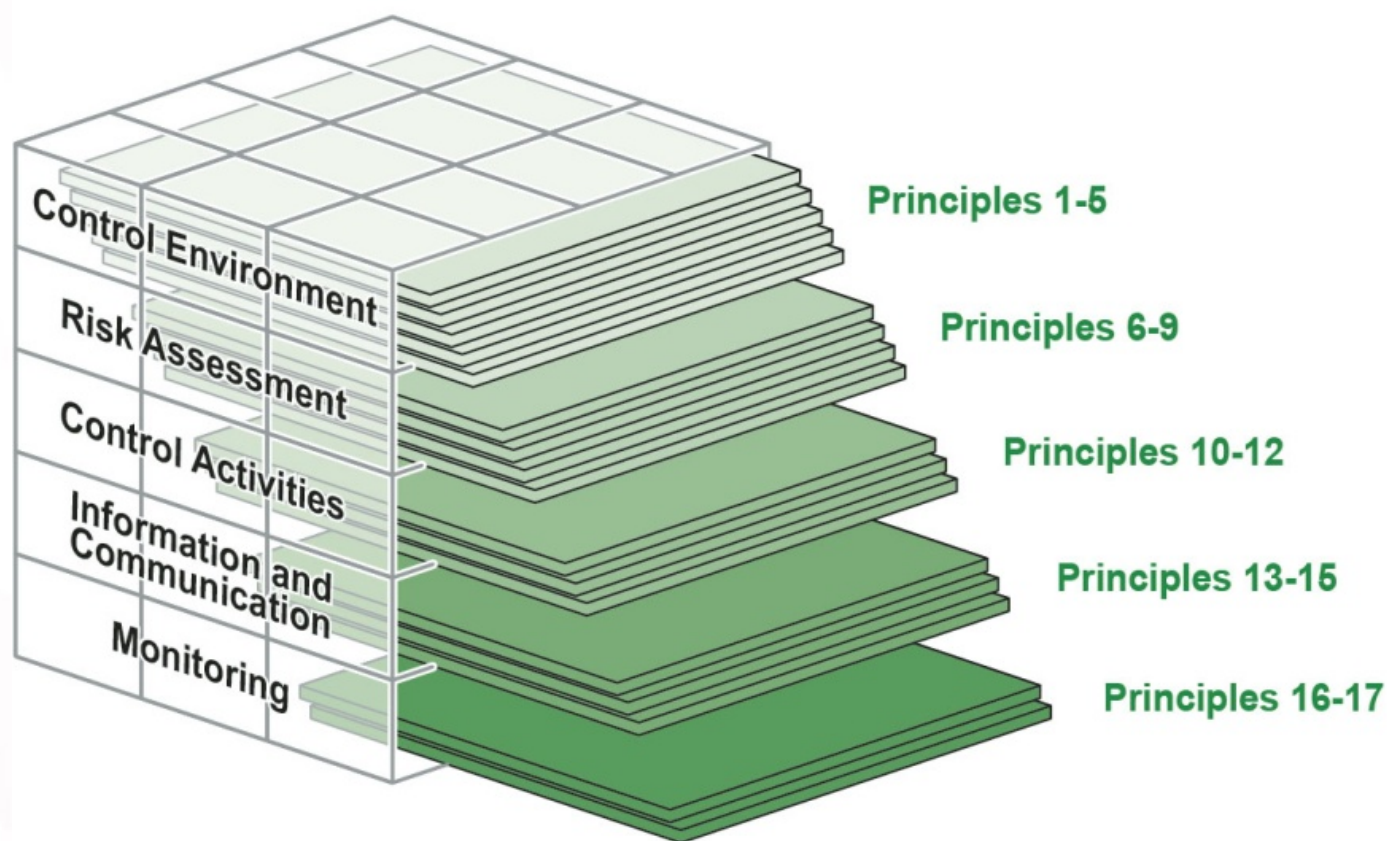
Module 1: Introduction to Internal Control Principles

Principles - The 17 principles support the effective design, implementation, and operation of the associated components and represent requirements necessary to establish an effective internal control system. (Para. OV2.05)



Source: GAO.

Module 1: Introduction to Internal Control Components and Principles



Source: GAO.

Module 1: Introduction to Internal Control Components and Principles

Components

Control Environment

Risk Assessment

Control Activities

Information & Communication

Monitoring Activities

Principles

1. Demonstrate Commitment to Integrity and Ethical Values
2. Exercise Oversight Responsibility
3. Establish Structure, Responsibility, and Authority
4. Demonstrate Commitment to Competence
5. Enforce Accountability

6. Define Objectives and Risk Tolerances
7. Identify, Analyze, and Respond to Risk
8. Assess Fraud Risk
9. Analyze and Respond to Change

10. Design Control Activities
11. Design Activities for the Information System
12. Implement Control Activities

13. Use Quality Information
14. Communicate Internally
15. Communicate Externally

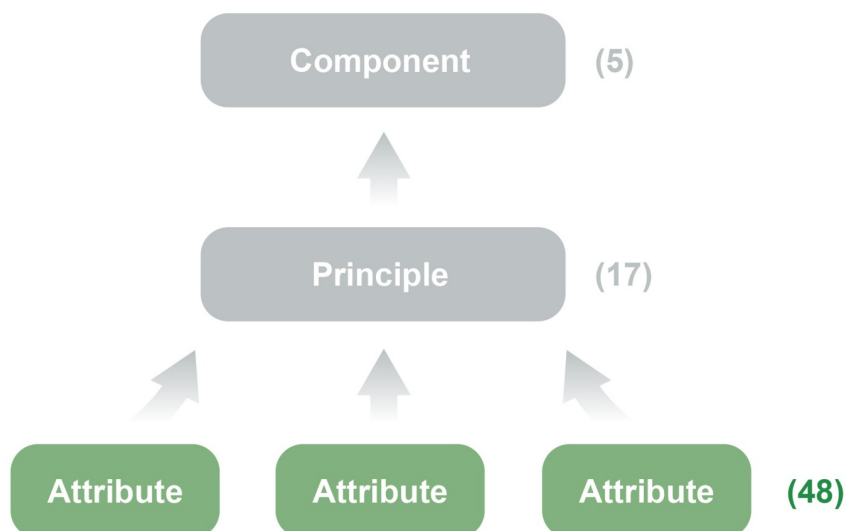
16. Perform Monitoring Activities
17. Remediate Deficiencies

Source: GAO.

Module 1: Introduction to Internal Control

Attributes

Attributes - Each principle has important characteristics, called attributes, which explain principles in greater detail. (Para. OV2.07-8)



Source: GAO.

Module 1: Introduction to Internal Control Component, Principle, and Attributes

Component

Control environment

Principle

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

Attributes

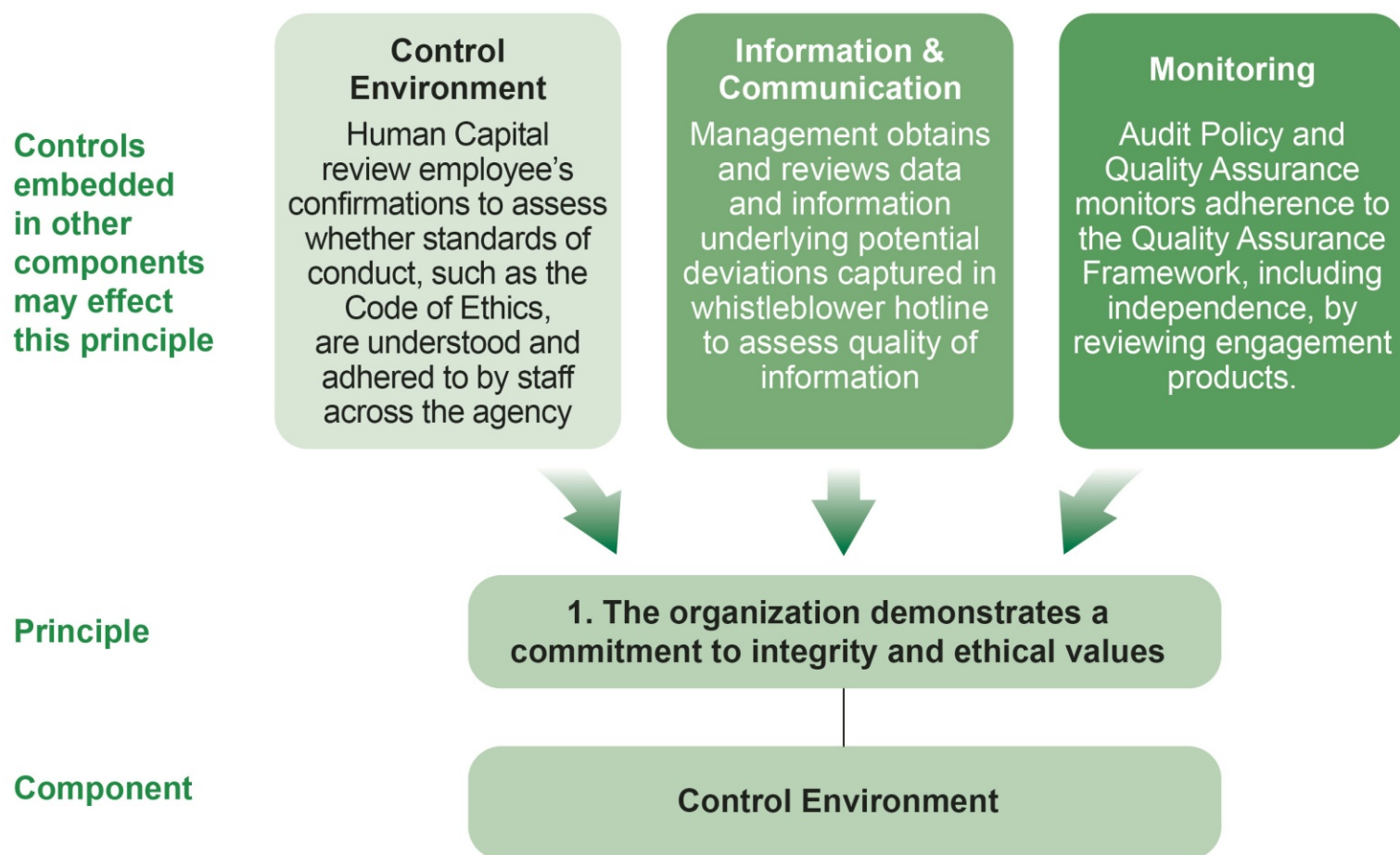
Set the Tone at the Top

Establish standards of conduct

Evaluate adherence to standards of conduct

Source: GAO.

Module 1: Introduction to Internal Control Controls Across Components



Source: GAO.

Module 1: Introduction to Internal Control

Internal Control Requirements

COMPONENTS & PRINCIPLES

=

CRITERIA

Module 1: Introduction to Internal Control

Internal Control Requirements (cont.)

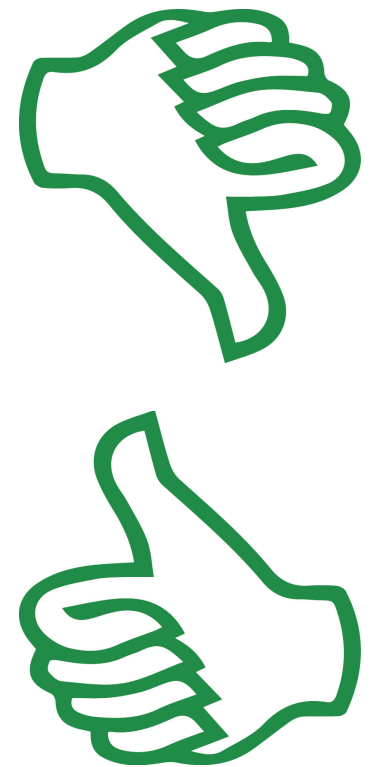
- Attributes are relevant to the proper implementation of the Green Book, but are **NOT** requirements.
- How to use attributes to discuss findings in audit?
 - Use attributes to provide context and describe how a principle was not met.
 - Do not cite attributes as criteria. However, attributes can be used to support criteria by further explaining the principle requirements.

Module 1: Introduction to Internal Control

Internal Control Requirements (cont.)

Examples of audit report wording for attributes:

- **POOR** – The agency had an ineffective control environment because management had not established standards of conduct.
- **GOOD** – The agency may not be able to meet its program goals because of an ineffective control environment. During our testing, we noted that management was unable to demonstrate a commitment to integrity and ethical values, a requirement for an effective control environment. Steps such as establishing agency-wide standards of conduct or adherence policies can help demonstrate this commitment.



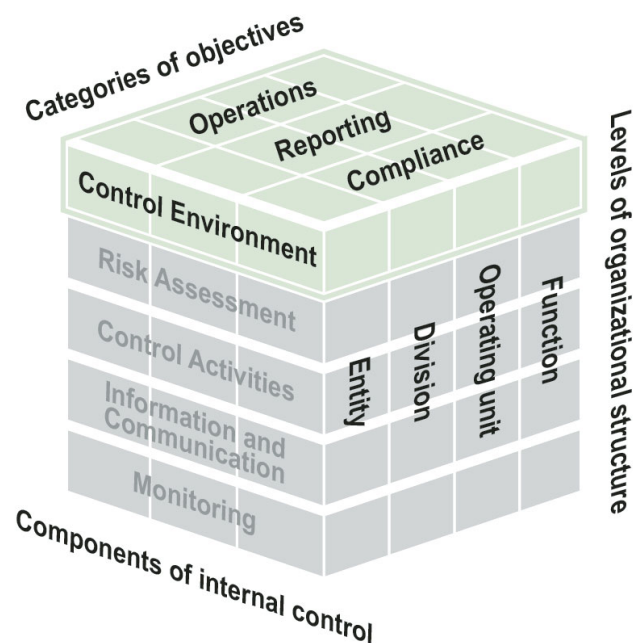
Module 2: Components of Internal Control

- Five components of internal control
 - Principles of internal control
 - Key concepts for principles
 - Red flags
- Case study activities

Module 2: Components of Internal Control

Control Environment

Control Environment - The foundation for an internal control system. It provides the discipline and structure to help an entity achieve its objectives. (Para. OV2.04)



Sources: COSO, GAO.

Module 2: Components of Internal Control Control Environment (cont.)

The control environment component contains the following five principles:

- The oversight body and management should demonstrate a commitment to integrity and ethical values. (Para. 1.01)
- The oversight body should oversee the entity's internal control system. (Para. 2.01)
- Management should establish an organizational structure, assign responsibility, and delegate authority to achieve the entity's objectives. (Para. 3.01)
- Management should demonstrate a commitment to recruit, develop, and retain competent individuals. (Para. 4.01)
- Management should evaluate performance and hold individuals accountable for their internal control responsibilities. (Para. 5.01)

Module 2: Components of Internal Control

Control Environment – Red Flags

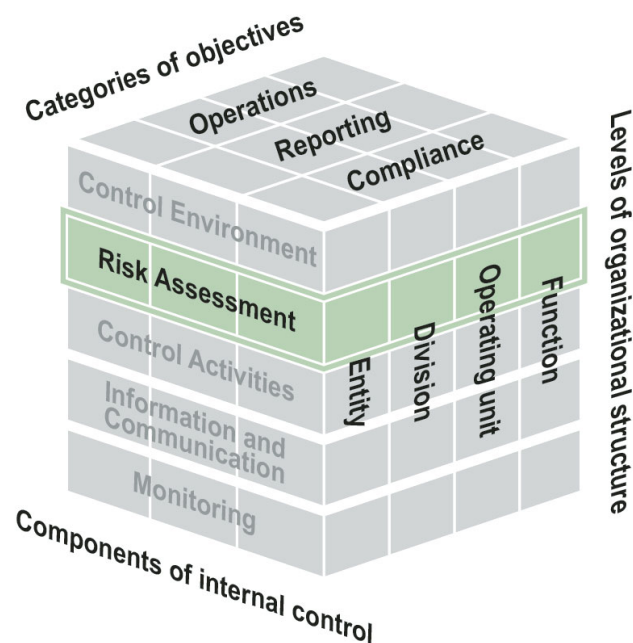
Examples that could indicate an internal control deficiency and require further analysis:

- Personnel do not understand what behavior is acceptable or unacceptable.
- Top management is unaware of actions taken at the lower level of the entity.
- It is difficult to determine the entities or individuals that have responsibility for programs or particular parts of a program.
- The entity's structure is inefficient or dysfunctional.
- Management displays a lack of concern for internal control and is unresponsive to internal control deviations or recommendations to improve internal control.



Module 2: Components of Internal Control Risk Assessment

Risk Assessment - Assesses the risks facing the entity as it seeks to achieve its objectives. This assessment provides the basis for developing appropriate risk responses. (Para. OV2.04)



Sources: COSO, GAO.

Module 2: Components of Internal Control Risk Assessment (cont.)

The risk assessment component contains the following four principles:

- Management should define objectives clearly to enable the identification of risks and define risk tolerances. (Para. 6.01)
- Management should identify, analyze, and respond to risks related to achieving the defined objectives. (Para. 7.01)
- Management should consider the potential for fraud when identifying, analyzing, and responding to risks. (Para. 8.01)
- Management should identify, analyze, and respond to significant changes that could impact the internal control system. (Para. 9.01)

Module 2: Components of Internal Control

Risk Assessment - Defining Objectives

Management is to define objectives in specific and measurable terms to enable the design of internal control for related risks.
(Para. 6.02)

- **Specific** - Specific terms are fully and clearly set forth so they can be easily understood.
- **Measurable** - Measurable terms allow for the assessment of performance toward achieving objectives.

Module 2: Components of Internal Control

Risk Assessment - Internal and External Changes

An entity's risk assessment process needs to capture significant changes that occur both externally and internally. (Para. 9.03)

- Internal changes include changes to the entity's programs or activities, oversight culture, organizational structure, personnel, and technology.
- External changes include changes in the governmental, economic, technological, legal, regulatory, and physical environments.

Module 2: Components of Internal Control Risk Assessment – Red Flags

Examples that could indicate an internal control deficiency and require further analysis:

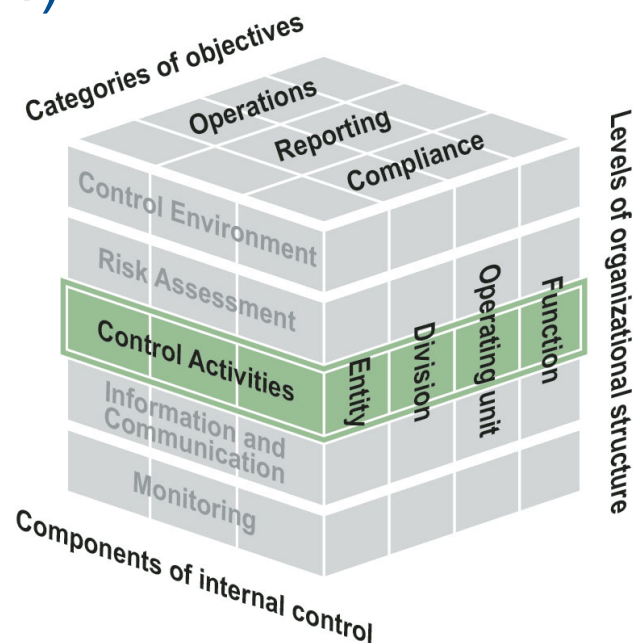
- Management has not reassessed the risk related to recent major changes — for example, new responsibilities, reorganization, cuts in funding, and expansion of programs.
- The agency or program does not have well-defined objectives.
- The agency or program does not have adequate performance measures.
- Management has not considered previous issues with fraud, waste, or abuse in the agency's risk assessment.
- The agency is unable to prioritize work appropriately.
- The agency is unaware of obstacles to its mission.
- The agency is not able to overcome obstacles to its mission efficiently or at all.



Module 2: Components of Internal Control

Control Activities

Control Activities - The actions management establishes through policies and procedures to achieve objectives and respond to risks in the internal control system, which includes the entity's information system. (Para. OV2.04)



Sources: COSO, GAO.

Module 2: Components of Internal Control

Control Activities (cont.)

The control activities component contains the following three principles:

- Management should design control activities to achieve objectives and respond to risks. (Para. 10.01)
- Management should design the entity's information system and related control activities to achieve objectives and respond to risks. (Para. 11.01)
- Management should implement control activities through policies. (Para. 12.01)

Module 2: Components of Internal Control

Control Activities (cont.)

The Green Book provides examples of common categories of control activities (fig. 6 on p. 46). These are meant to aid understanding of what is meant by control activities but are not requirements or criteria.

EXAMPLES  CRITERIA

Module 2: Components of Internal Control

Control Activities – Red Flags

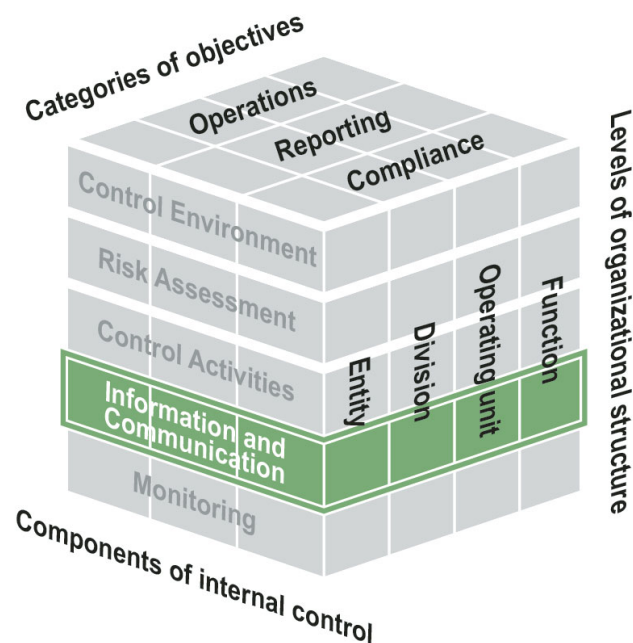
Examples that could indicate an internal control deficiency and require further analysis:

- Employees are unaware of policies and procedures, but do things the way “they have always been done.”
- Operating policies and procedures have not been developed or are outdated.
- Key documentation is often lacking or does not exist.
- Key steps in a process are not being performed.
- Personnel and management are uncertain why processes are being performed or how processes are related to and support program goals.



Module 2: Components of Internal Control Information and Communication

Information and Communication – The quality information management and personnel communicate and use to support the internal control system. (Para. OV2.04)



Sources: COSO, GAO.

Module 2: Components of Internal Control Information and Communication (cont.)

The information and communication component contains the following three principles:

- Management should use quality information to achieve the entity's objectives. (Para. 13.01)
- Management should internally communicate the necessary quality information to achieve the entity's objectives. (Para. 14.01)
- Management should externally communicate the necessary quality information to achieve the entity's objectives. (Para. 15.01)

Module 2: Components of Internal Control Information and Communication (cont.)

Quality Information - Information from relevant and reliable data that is appropriate, current, complete, accurate, accessible, and provided on a timely basis, and meets identified information requirements. (Para. 13.05)

Management communicates quality information **internally** and **externally** through reporting lines in order to help the entity achieve its objectives and address related risks. (Paras. 14.02-14.03 and 15.02-15.03)

Module 2: Components of Internal Control Information and Communication – Red Flags

Examples that could indicate an internal control deficiency and require further analysis:

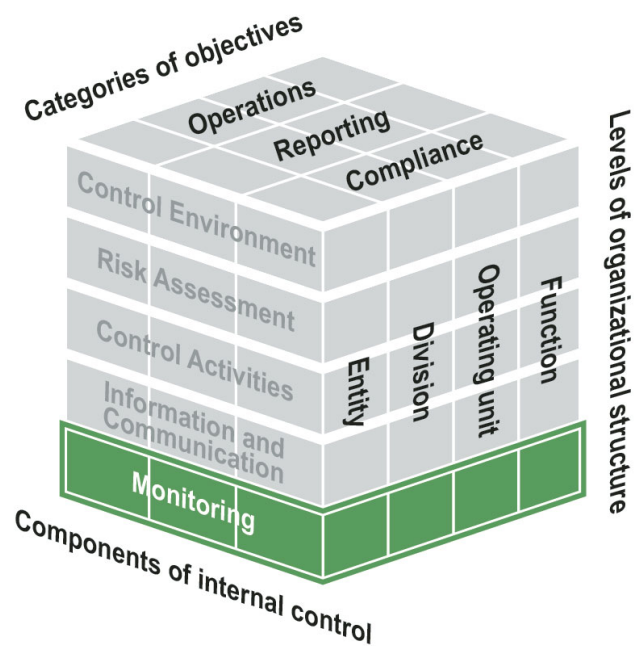
- When top management needs information, there is an excessive rush to assemble the information, or the process is handled through ad hoc mechanisms (e.g., the information was not readily available).
- Key information requests for basic information on the status of operations from external stakeholders (e.g., Congress or GAO) are difficult for the agency to respond to and require extra resources or special efforts.
- Management is using poor quality information or outdated information for making decisions.
- Staff are frustrated by requests for information because it is time-consuming and difficult to provide the information.
- Management does not have reasonable assurance that the information it is using is accurate.
- Personnel are unaware of separate communication lines for reporting confidential information.



Module 2: Components of Internal Control

Monitoring

Monitoring - Activities management establishes and operates to assess the quality of performance over time and promptly resolve the findings of audits and other reviews. (Para. OV2.04)



Sources: COSO, GAO.

Module 2: Components of Internal Control Monitoring (cont.)

The monitoring component contains the following two principles:

- Management should establish and operate monitoring activities to monitor the internal control system and evaluate the results. (Para. 16.01)
- Management should remediate identified internal control deficiencies on a timely basis. (Para. 17.01)

Module 2: Components of Internal Control Monitoring (cont.)

Issue vs. Deficiency

- An issue is an unexpected result from a process. Management evaluates issues identified through monitoring activities or reported by personnel to determine whether any of the issues rise to the level of an internal control deficiency. (Para. 17.05)
- A deficiency exists when the design, implementation, or operation of a control does not allow management or personnel, in the normal course of performing their assigned functions, to achieve control objectives and address related risks. (Para. OV3.07)

Module 2: Components of Internal Control Monitoring – Red Flags

Examples that could indicate an internal control deficiency and require further analysis:

- Management does not evaluate a program on an ongoing basis.
- Significant problems exist in controls and management was not aware of those problems until a big problem occurred or until an outside party brought it to its attention.
- There are unresolved problems with the other components: control environment, risk assessment, control activities, and information and communications.
- Previously identified engagement findings are not being resolved adequately or timely.
- Management misses key deadlines and was not aware that it would not be able to meet deadlines.



15-Minute Break

Module 2: Components of Internal Control

Case Study



Some Parting Thoughts

- As auditors, we have a unique and special responsibility in accountability for the prudent use of public resources.
- Good internal control, accountability, and auditing are critical in the public sector for the effective and credible functioning of a healthy democracy, and in fulfilling the government's responsibility to citizens and taxpayers.
- The public relies on us to report whether government services are being provided efficiently, effectively, economically, and in compliance with laws and regulations.
- “Getting it right” with regard to internal control is a key part of an auditor's role, and will keep getting more important as the fiscal situation becomes increasingly more difficult.

Where to Find the Green Book

- The Green Book is on GAO's website at:
www.gao.gov/greenbook
- For questions on internal control, contact us at:
greenbook@gao.gov

Questions?