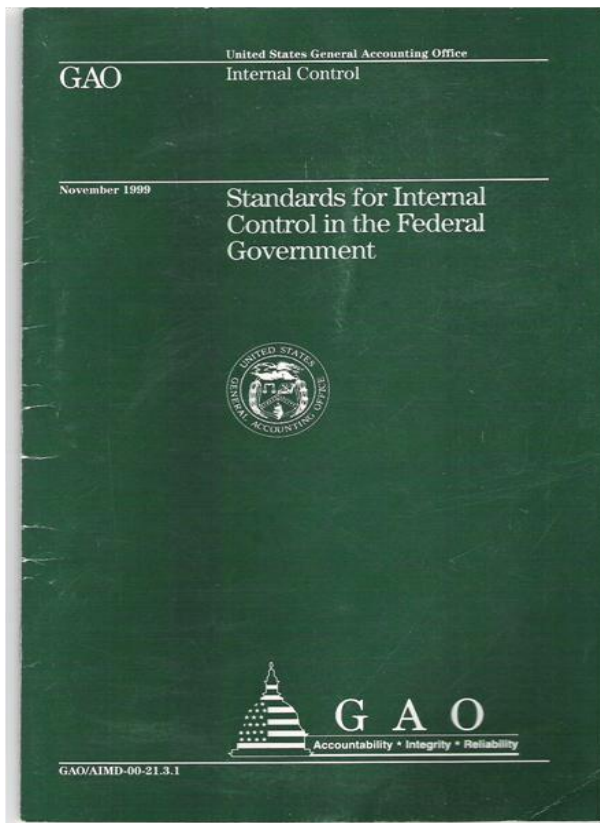# Standards for Internal Control in the Federal Government

Going Green

Session Objectives

- To discuss GAO's revision to the *Standards for Internal Control in the Federal Government* (Green Book)

- To discuss why internal controls are a key tool government managers use

Green Book Revision Proposed Timeline

Outreach to User Community	Green Book Advisory Council	Public Exposure (90 day comment period)	Close Exposure Period
Ongoing	May 20, 2013	September 3, 2013	December 2, 2013

Reasons for Green Book Revision

- Last issued in November 1999

- Adapt to a more global, complex, and technological landscape

- Maintain relevancy to changing standards

- Harmonize federal standards with the updated Committee of Sponsoring Organizations of the Treadway Commission (COSO) Framework

What's in Green Book for the Federal Government?

- Reflects federal internal control standards required per Federal Managers' Financial Integrity Act (FMFIA)

- Serves as a base for OMB Circular A-123

- Written for government
 - Leverages the COSO Framework
  - Uses government terms

What's in Green Book for State and Local Governments?

- May be an acceptable framework for internal control on the state and local government level under proposed OMB Uniform Guidance for Federal Awards

- Written for government
  - Leverages the COSO Framework
  - Uses government terms

What's in Green Book for Management and Auditors?

- Provides a framework for management

- Provides criteria for auditors

- Can be used in conjunction with other standards, e.g. Yellow Book

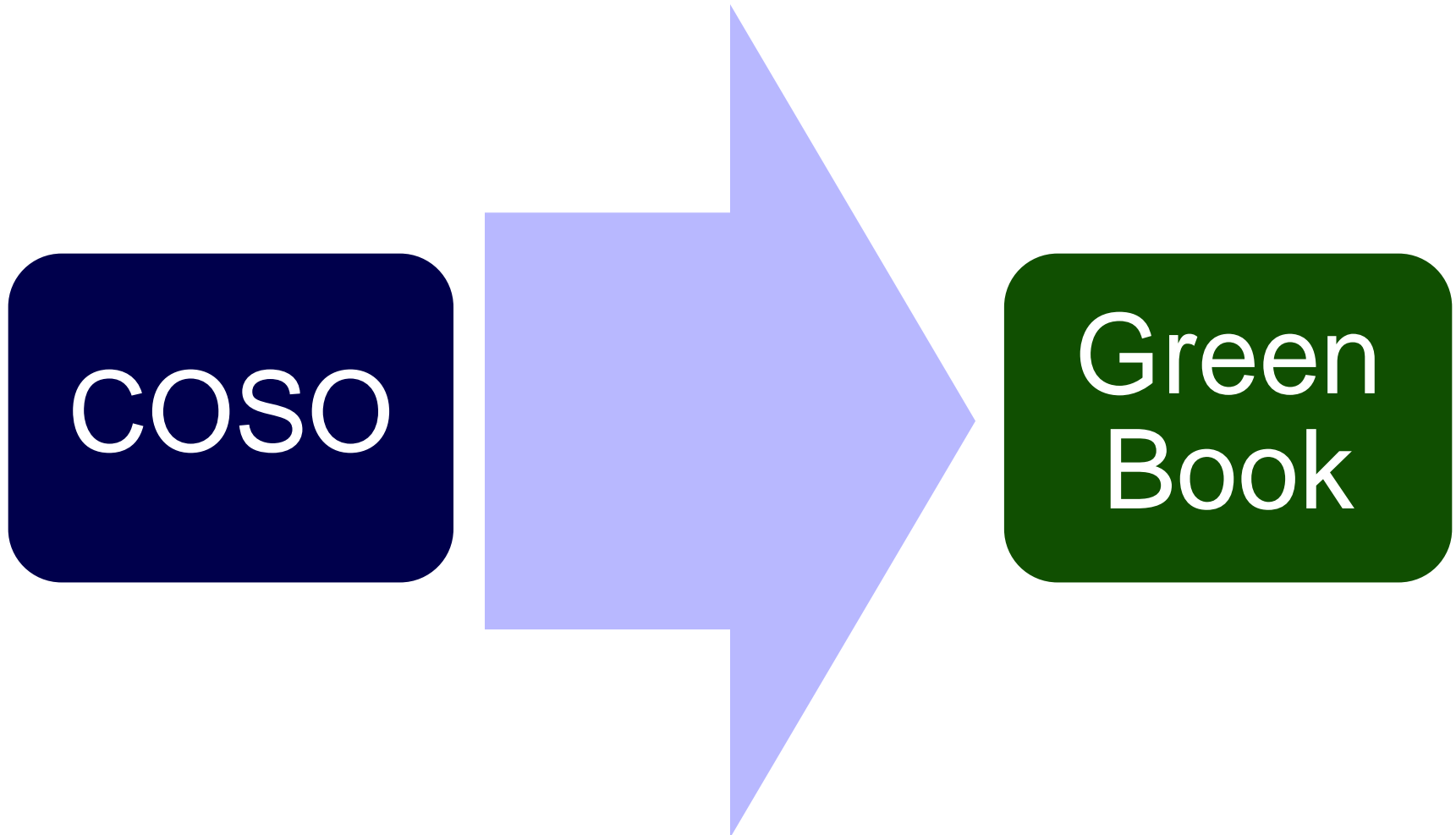# Updated COSO Framework
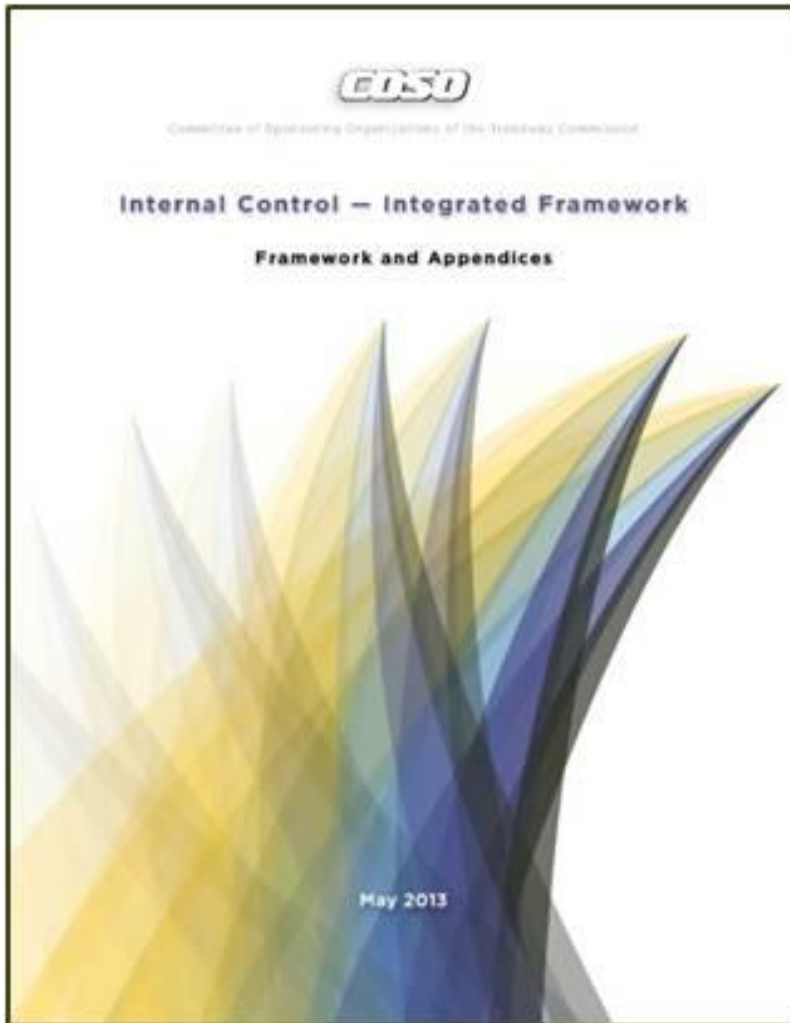
Released
May 14, 2013

The COSO Framework

- ## Relationship of Objectives and Components

  - Direct relationship between objectives (which are what an entity strives to achieve) and the components (which represent what is needed to achieve the objectives)

- ## COSO depicts the relationship in the form of a cube:

  - The three objectives are represented by the columns
  - The five components are represented by the rows
 - The entity's organization structure is represented by the third dimension

Source: COSO

From COSO to Green Book: Harmonization

COSO → Green Book

Green Book Revision Process

- Retained five original COSO components
- Adapted COSO Framework's language to make it appropriate for a federal government standard
- Adapted the concepts for a government environment where appropriate
- Considered clarity drafting conventions
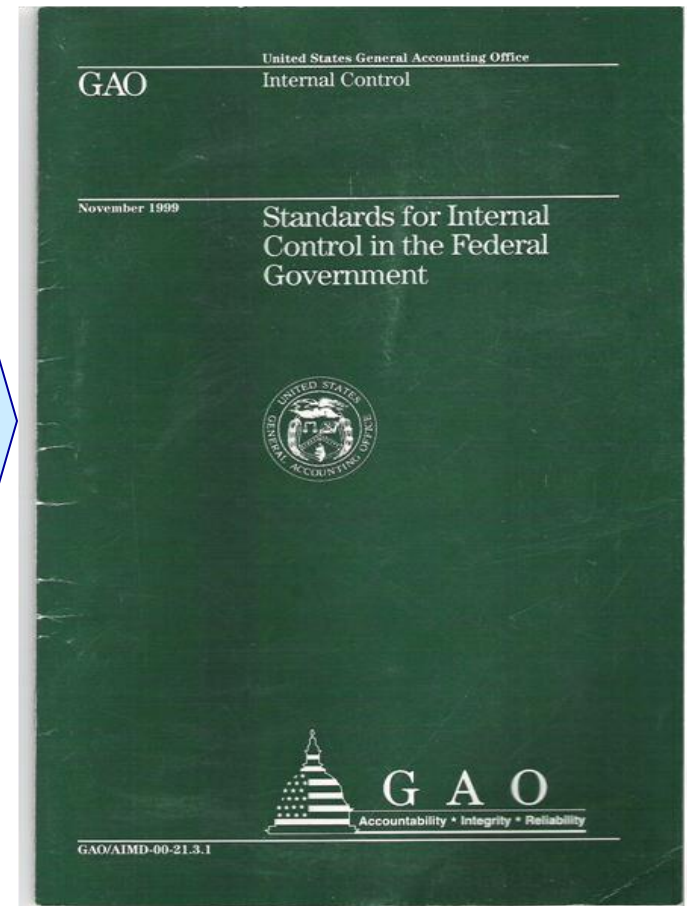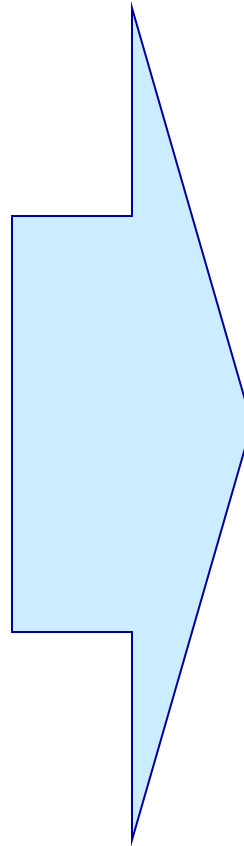- Considered INTOSAI internal control guidance
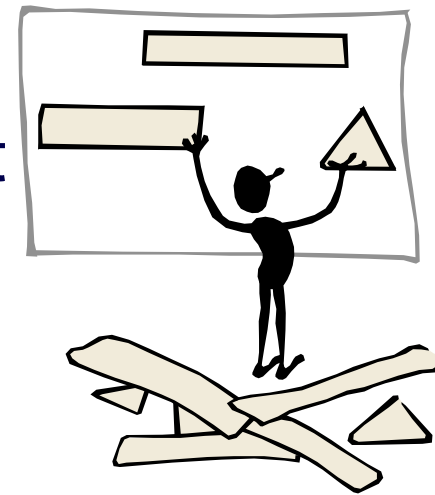
Green Book Advisory Council

Representation from:

- Federal agency management (nominated by OMB)
- Inspector General
- State and local government
- Academia
- COSO
- Independent public accounting firms
- At large

Revised Green Book: Standards for Internal Control in the Federal Government

Overview

Standards

Revised Green Book: Overview

- Explains fundamental concepts of internal control

  Overview

  Standards

- Addresses how components, principles, and attributes relate to an entity's objectives

- Discusses management evaluation of internal control

Fundamental Concepts

- ## What is internal control?
  - Green Book defines internal control in O1.03 as, "Internal control comprises the plans, methods, policies, and procedures used to fulfill the mission, strategic plan, goals, and objectives of the organization. Internal control serves as the first line of defense in safeguarding assets. In short, internal control helps federal managers achieve desired results through effective stewardship of public resources."

- ## What is an internal control system?
  - Green Book defines an internal control system in O1.04 as, "An internal control system is a continuous built-in component of operations, effected by people, that provides reasonable assurance, not absolute assurance, that an organization's objectives will be achieved."

Overview: Components, Principles, and Attributes

Overview

Standards

Achieve Objectives

↓

Components

↓

Principles

↓
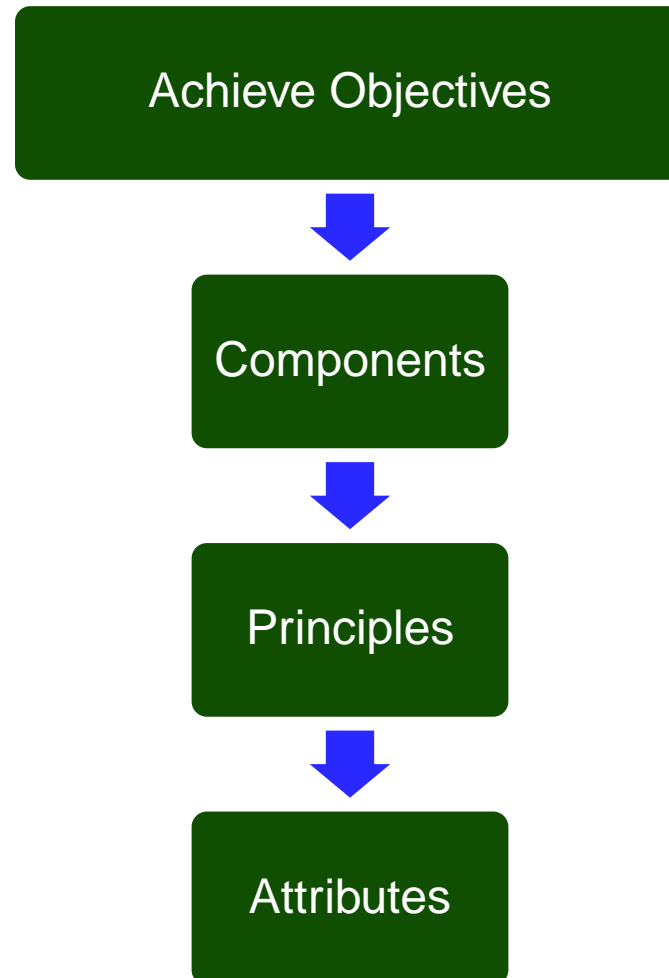
Attributes

Overview: Principles and Attributes

- In general, all components, principles, and attributes are required for an effective internal control system

- Principles and Attributes
    - Entity should implement relevant principles and attributes
    - If a principle or attribute is not relevant, document the rationale of how, in the absence of that principle or attribute, the associated component could be designed, implemented, and operated effectively

Overview: Management Evaluation

An effective internal control system requires that each of the five components are:

- Effectively designed, implemented, and operating
- Operating together in an integrated manner

Management evaluates the effect of deficiencies on the internal control system

A component is not likely to be effective if related principles and attributes are not effective

Overview: Additional Considerations

Overview

Standards

The impact of service organizations on an entity's internal control system

Discussion of documentation requirements in the Green Book

Applicability to state, local, and quasi-governmental entities as well as not-for-profits

Cost/Benefit and Large/Small Entity Considerations

Revised Green Book: Standards

- Control Environment

- Risk Assessment

- Control Activities

- Information and Communication

- Monitoring

Revised Green Book: Standards

Overview

Standards

- Discusses requirements of each component

- Explains principles and attributes for each component

- Includes application material for each attribute

Control Environment

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

- 2. The oversight body should oversee the entity's internal control system.

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

Control Environment (cont.)

- 4. Management should demonstrate a commitment to attract, develop, and retain competent individuals.

- 5. Management should evaluate performance and hold individuals accountable for their internal control responsibilities.

Risk Assessment

- 6. Management should define objectives and risk tolerances.

- 7. Management should identify, analyze, and respond to risks related to achieving the defined objectives.

- 8. Management should consider the potential for fraud when identifying, analyzing, and responding to risks.

- 9. Management should identify, analyze, and respond to significant changes in the internal control system.

Control Activities

- 10. Management should design control activities to achieve objectives and risk responses.

- 11. Management should design control activities for the entity's information system.

- 12. Management should implement control activities.

Attributes for Principle 10

- Management should design control activities that respond to the entity's objectives and risks.

- Management should design appropriate types of control activities needed for the entity's internal control system.

- Management should design control activities at appropriate levels in the organizational structure

- Management should consider segregation of duties in designing the assignment of control activity responsibilities.

Information & Communication

- 13. Management should use quality information.

- 14. Management should internally communicate the necessary quality information.

- 15. Management should externally communicate the necessary quality information.

Monitoring

- 16. Management should establish monitoring activities to monitor the internal control system and evaluate the results.

- 17. Management should ensure identified internal control deficiencies are remediated on a timely basis.

Standards: COSO vs. Green Book

Component	COSO	Green Book
Control Environment	**5** Principles **20** Points of Focus	**5** Principles **14** Attributes
Risk Assessment	**4** Principles **27** Points of Focus	**4** Principles **10** Attributes
Control Activities	**3** Principles **16** Points of Focus	**3** Principles **11** Attributes
Information & Communication	**3** Principles **14** Points of Focus	**3** Principles **7** Attributes
Monitoring	**2** Principles **10** Points of Focus	**2** Principles **6** Attributes

Overview

Standards

Note: GAO combined COSO's points of focus into attributes

Standards: Harmonization from COSO to Green Book

Commercial Concepts

Government Concepts

- Board of Directors
- Investors

- Oversight Body
- Stakeholders

Standards: Harmonization Example

COSO (Principle 2)

The board of directors demonstrates independence from management and exercises oversight of the development and performance of internal control.

Green Book (Principle 2)

The oversight body should oversee the entity's internal control system.

Other Key Differences

- Criteria vs. Framework

- Documentation Requirements
  - O4.08 lists the five documentation requirements found in the Green Book which represent the minimum level of documentation necessary for an effective internal control system.

- Evaluation includes the attribute level
  - O3.09 discusses how management considers the design, implementation, and operating effectiveness of the attributes for each principle

Documentation Requirements

- Control Environment
  - 3.12: Management should develop and maintain documentation of its internal control system.

- Control Activities
  - 12.03: Management should document in policies the internal control responsibilities of the organization.

Documentation Requirements (cont.)

- Monitoring
    - 16.12: Management should evaluate and document the results of ongoing monitoring and separate evaluations to identify internal control issues.

    - 17.07: Management should evaluate and document internal control issues and determine appropriate corrective actions for internal control deficiencies on a timely basis.

    - 17.09: Management should complete and document corrective actions to remediate internal control deficiencies on a timely basis.

The Green Book in Action

- Relationship between the Green Book and Yellow Book

- An internal control case study illustrating how the Green Book could help managers and auditors address identified issues

Green Book and Yellow Book
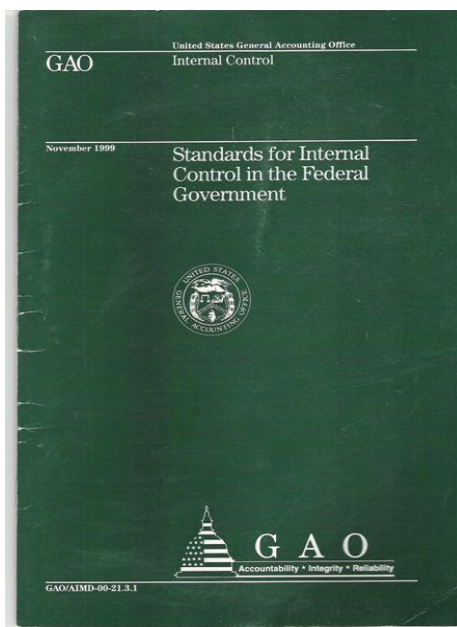
- Can be used by management to understand requirements

- Can be used by auditors to understand criteria

The Yellow Book: Framework for Audits

- Findings are composed of
  - Condition (What is)

  - **Criteria (What should be)**

  - Cause

  - Effect (Result)

  - Recommendation (as applicable)

Linkage Between Criteria (Yellow Book) and Internal Control (Green Book)

- Green Book provides criteria for the design, implementation, and operating effectiveness of an effective internal control system
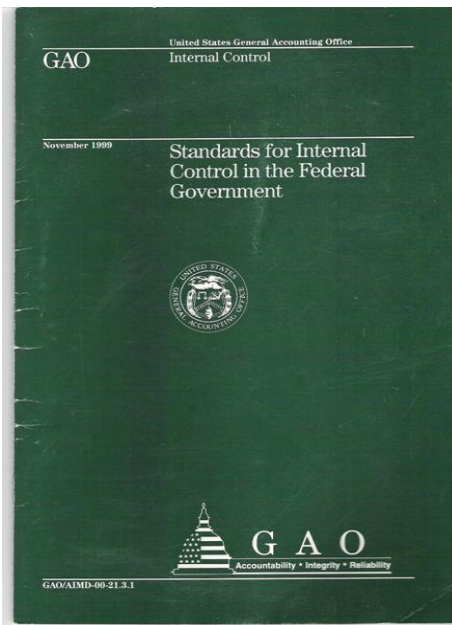
The Yellow Book: Framework for Audits

- Findings are composed of
  - Condition (What is)

  - Criteria (What should be)

  - **Cause**

  - Effect (Result)

  - Recommendation (as applicable)

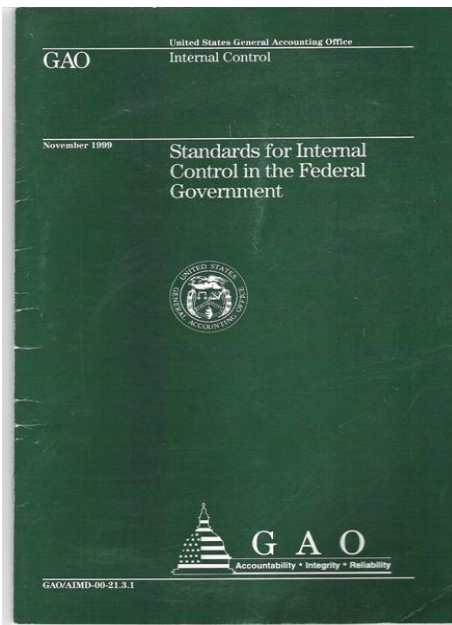# Linkage Between Findings (Yellow Book) and Internal Control (Green Book)

- Findings may have causes that relate to internal control deficiencies

Implications of Ineffective Internal Controls

More than $154 Million in Questioned and Unsupported Costs in [Grant Recipients] Proposed Budget

Improper Release of Personally Identifiable Information

Internal Controls Over [Entity's] Staff Retreats Could Be Improved

More than $6.3 Million of Questioned Costs at the University of [Green's Higher Education]

Additional Audit Work Confirms $88 Million of Unallowable Contingency Costs in Construction Budget

Case Study: "Green" State University

- GAO reviewed a grant program from the Department of Education

- Identified a number of issues in a grant recipient's management of the funds received

Note: Names have been changed for this case presentation.

Program Purpose

Program was established to help colleges and universities become self-sufficient and expand their capacity to serve low-income or minority students

Issues Identified

- Questionable costs charged

- Credit card manager hired after costs had been questioned by external reviewers

- Process for credit card charge approvals able to be circumvented

- Lack of documentation for key aspects of the program

- Internal Auditor had never performed an audit of the program

Ornate Desk ($6,180)

Pictures of Desk Inscription and Matching Ornate Chair

Aeronautical GPS Unit

- Purchased for $4,578 also a split purchase to circumvent the control of approval of purchases over $2,500

- Presented it to Dr. Hamm and Mr. George

    - Mr. George was convinced we were mistaken, it could not have been for a plane

Aeronautical GPS Unit

- The GPS was purchased by Dr. Program Manager and a former security officer of the school, Mr. Random

- Mr. Random does not work at "Green" State, currently works as a State Investigator

- They believed it would be a good idea for them to take students in an airplane to teach them how to navigate aeronautically

- Dr. Program Manager stated that "*if students can navigate in a plane around the country, then they would be able to navigate themselves around the campus… and through life.*"

- "Green" State does not own a private plane; it belongs to Mr. Random, who is in possession of the GPS

Control Environment

- No clear linkage of the university's program to the objectives of the grant

- Structure of entity
  - Position of credit card manager should have existed from program inception

- Tone at the top
  - Flagrant abuse by personnel reinforces a unhealthy culture
  - Management enabling personnel to side-step control activities erodes tone at the top

Risk Assessment

- No risk assessment performed

- From the lack of risk assessment the following issues:
  - Risks that could stop the program from achieving its objectives were not identified
  - Risk responses were not formulated
  - Which meant that control activities could not be properly to designed to both achieve the program's objectives and address the related risks

Control Activities

- Policies and procedures had been formulated after issues were identified:
  - Credit limit of $2,500
  - Documentation required in the form of invoices and receipts for expenditures

- However, in practice these activities were able to be circumvented

- No clear linkage of policies and procedures to the objectives of the program

Further Examination

- A review of expenditures by lead on the program, Dr. Program Manager, revealed that Dr. Program Manager took students on vacation like trips to areas all over the United States, including:

Orlando, Florida

Student Activities

- During these trips students participated in conventions and retreat/resort activities such as white water rafting

Paintballing

Drum Making

Hiking

Yoga in the Woods

Universal Studio Tours

Catered Meals

Information & Communication

- Lack of communication between employees
  - When existing policies prevented a charge from occurring management allowed an override of control instead of communicating with the credit card manager.

- Lack of information
  - Documentation requirements were not enforced and therefore designed control activities could not operate the way they were meant, and management didn't have the information to determine that charges were questionable.

Monitoring

- Management did not review the operations of the program
  - Possible use of data mining for a simple review

- Internal Audit hadn't performed one audit of the program; walked around to identify any problems on campus

Data Mining – Red Flags

- Be aware of:
    - Transactions that fall right below the threshold
    - Split transactions
    - Multiple charges on the same day
    - Round numbers
    - Repeat charges of the same amount
    - Unusual vendors
    - Unusual purchases that do not fit with the intent of the program
- Use judgment

Highlighted transactions

8-Mar-06	Georgian Terrace Hotel-02052006	26-Feb-06	87.72
8-Mar-06	Chevron 00202298-02032006	26-Feb-06	39.05
8-Mar-06	Daily A Garage 2-02052006	26-Feb-06	80.00
8-Mar-06	Staples #148-02052006	26-Feb-06	70.20
8-Mar-06	Zyzyx-02022006	26-Feb-06	1,180.00
8-Mar-06	Zyzyx-02022006	26-Feb-06	2,500.00
8-Mar-06	Zyzyx-02022006	26-Feb-06	2,500.00
8-Mar-06	Umcp Cashier-02022006	26-Feb-06	60.00
8-Mar-06	Avis Rent-A-Car 1-02052006	26-Feb-06	447.88
8-Mar-06	Fedex Kinko'S #1814-02022006	26-Feb-06	4.71
8-Mar-06	Fedex Kinko'S #1814-02012006	26-Feb-06	25.18
8-Mar-06	Fedex Kinko'S #1814-02022006	26-Feb-06	202.23

Highlighted transactions

14-Jun-06	Fedex Kinkos-04222006	26-May-06	11.32
14-Jun-06	Fedex Kinkos-04222006	26-May-06	1.89
14-Jun-06	Fedex Kinkos-04222006	26-May-06	7.32
14-Jun-06	The Gift Shop At Reg-04222006	26-May-06	124.84
14-Jun-06	Seattle Avionics Inc-03302006	26-May-06	2,484.00
14-Jun-06	Xm Satellite Radio-04202006	26-May-06	104.99
14-Jun-06	Seattle Avionics Inc-03312006	26-May-06	2,093.97

- Highlighted the transactions we found through data mining that looked questionable for both credit card expenditures and accounts payables expenditures

Where to Find the Green Book

- The Green Book is on GAO's website at: www.gao.gov/greenbook

- For technical assistance, contact us at: greenbook@gao.gov

Thank You

Questions?

Government Auteur Standards

Yellow Book Update

GAO
U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Yellow Book Update

- New Interpretations & Reminders

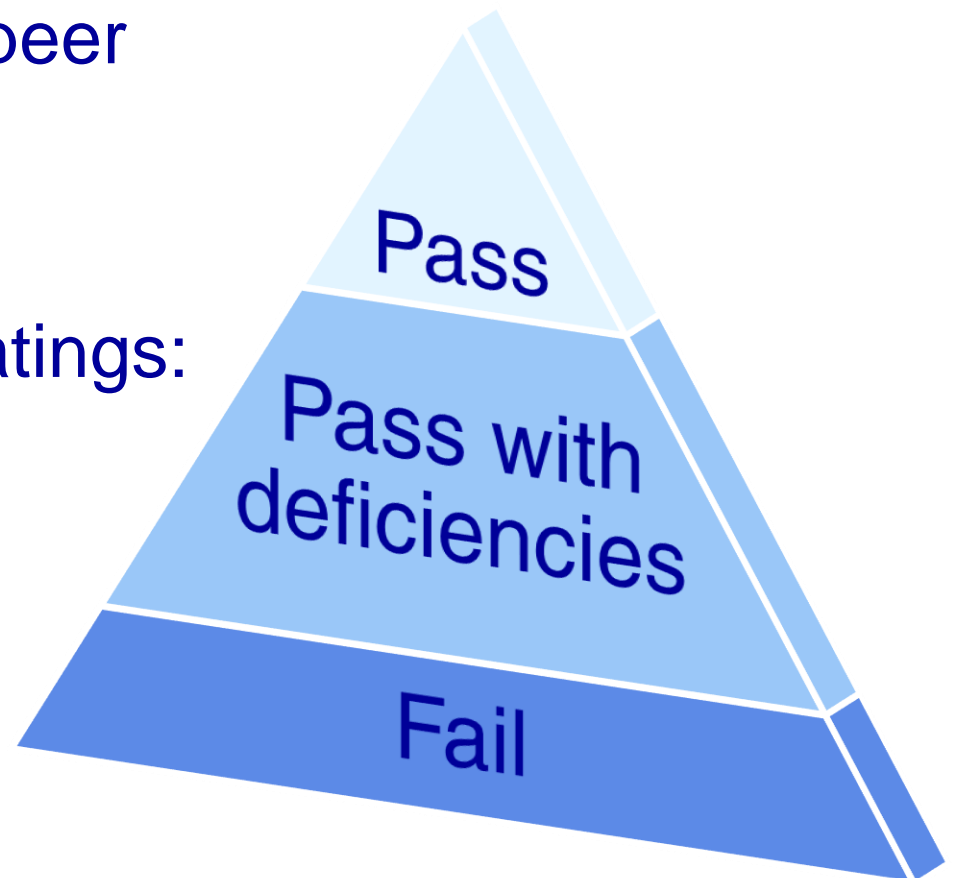- Conceptual Framework

- Implementation Challenges

New Interpretations

1. Same authority as Yellow Book

2. Presented to Advisory Council

3. Addressed with key stakeholders

4. Posted to GAO website once finalized

Reminder - Peer Reviews

The peer review team uses professional judgment in deciding the type of peer review report

Types of peer review ratings:

Pass

Pass with deficiencies

Fail

Conceptual Framework

1. Identify threats to independence

2. Evaluate the significance of the threats identified, both individually and in the aggregate

3. Apply safeguards as necessary to eliminate the threats or reduce them to an acceptable level

4. Evaluate whether the safeguard is effective

Documentation Requirement:

Para 3.24: When threats are not at an acceptable level and require application of safeguards, auditors should document the safeguards applied

Conceptual Framework

Applying The Framework

Threats could impair independence

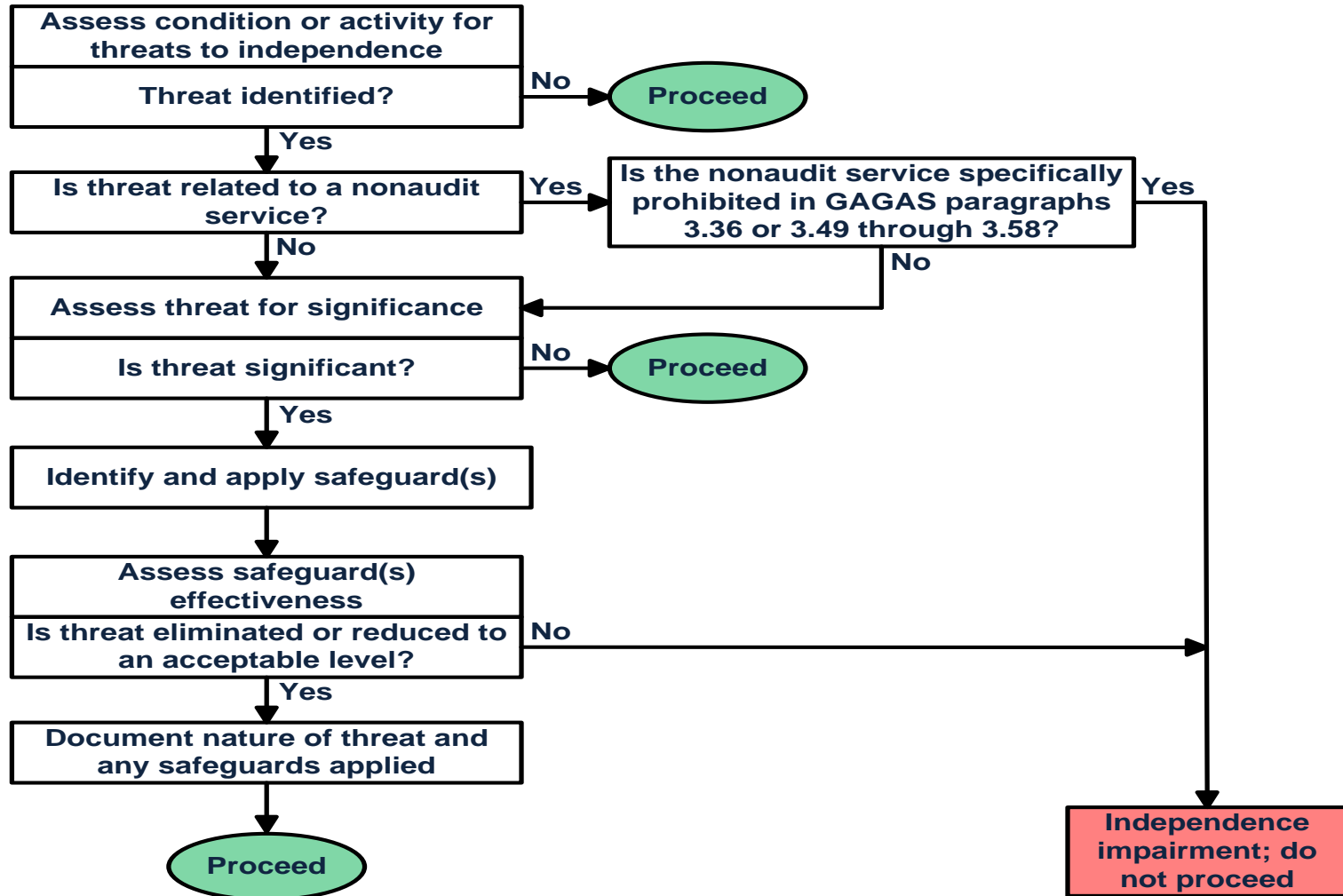- Do **not** necessarily result in an independence impairment

Safeguards could mitigate threats

- Eliminate or reduce to an acceptable level

Applying the Framework: Categories of Threats

1. Management participation threat
2. Self-review threat
3. Bias threat
4. Familiarity threat
5. Undue influence threat
6. Self-interest threat
7. Structural threat

Assess condition or activity for threats to independence

Threat identified? — No → *Proceed*

Yes ↓

Is threat related to a nonaudit service? — Yes → **Is the nonaudit service specifically prohibited in GAGAS paragraphs 3.36 or 3.49 through 3.58?** — Yes →

No ↓

Assess threat for significance

Is threat significant? — No → *Proceed*

Yes ↓

Identify and apply safeguard(s)

↓

Assess safeguard(s) effectiveness

Is threat eliminated or reduced to an acceptable level? — No →

Yes ↓

Document nature of threat and any safeguards applied

↓

Proceed

Independence impairment; do not proceed

Additional Documentation Requirements

1. Auditors must document assessment of SKE

2. Auditors must document application of safeguards in place

Implementation Challenges

- Non-audit services

    Assessment of SKE (Skill, Knowledge and Experience)

- SKE is assessed before conceptual framework

Reminder - Continuing Professional Education (CPE)

No revision to overall requirements

- Minimum of 24 hours of CPE every 2 years
  - Government
  - Specific or unique environment
  - Auditing standards and applicable accounting principles
- Additional 56 hours of CPE for auditors involved in
  - Planning, directing, or reporting on GAGAS assignments; or
  - Charge 20 percent or more of time annually to GAGAS assignments
- Minimum of 20 hours of CPE each year

Where to Find the Yellow Book

- The Yellow Book is available on GAO's website at:

  www.gao.gov/yellowbook

- For technical assistance, contact us at:

  yellowbook@gao.gov

  or call (202) 512-9535