



Internal Controls and Risk Management

Welcome to Week 6 of our course, where we'll explore the critical world of internal controls and risk management. Throughout this presentation, we'll examine the frameworks, types, and testing of controls that help organizations safeguard assets, ensure accurate financial reporting, and maintain regulatory compliance.

Definition of Internal Controls

Internal controls are the processes designed and implemented by an organization to provide reasonable assurance regarding:

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

These controls serve as the foundation of an organization's risk management strategy, helping to prevent errors and fraud while ensuring business objectives are met.



COSO Framework

Overview



The Committee of Sponsoring Organizations (COSO) framework provides a comprehensive structure for designing and evaluating internal controls. This integrated framework consists of five interrelated components that work together to create an effective control system.

The control environment forms the foundation, establishing the organization's ethical tone, while monitoring activities at the top ensure controls remain effective over time.

Types of Controls: Preventive, Detective, Corrective



Preventive Controls

Designed to stop errors or fraud before they occur. Examples include segregation of duties, proper authorization, physical controls, and input validation.



Detective Controls

Identify errors or problems that have already occurred. Examples include reconciliations, reviews, audits, and exception reports.



Corrective Controls

Remedy problems discovered by detective controls. Examples include backup and recovery procedures, disciplinary actions, and reprocessing transactions.



Control Testing Techniques

1 Inquiry

Asking questions of appropriate personnel to understand processes and controls. Provides context but requires corroboration with other evidence.

2 Observation

Watching a process or procedure being performed. Useful for understanding workflow but limited to point-in-time assessment.

3 Inspection

Examining records, documents, or physical assets. Provides direct evidence of control operation and effectiveness.

4 Reperformance

Independently executing procedures or controls to verify the same results. Strongest form of testing evidence.



IT Controls in the Audit Environment

General IT Controls

- Access management
- Change management
- System development
- Backup and recovery

Application Controls

- Input validation
- Processing controls
- Output controls
- Interface controls

IT controls are increasingly critical in modern audit environments where most financial processes rely on technology. Effective IT governance requires both general controls that apply across systems and specific application controls that ensure data integrity within individual programs.



Real Cases of Control

Enron

Enron (2001)

Failure of oversight controls and independence issues led to fraudulent financial reporting and the company's collapse. Resulted in the creation of Sarbanes-Oxley Act.

Société Générale (2008)

Trader Jérôme Kerviel circumvented controls to create €4.9 billion in losses. Demonstrated failures in segregation of duties and monitoring controls.

Toshiba (2015)

Systematic overstatement of profits by \$1.2 billion over seven years due to management pressure and inadequate board oversight.

These real-world examples illustrate the devastating consequences when internal controls fail. They highlight the importance of robust control systems and the need for continuous monitoring and improvement.

Workshop Instructions: Audit Evidence Review

Workshop

Objectives

- Apply control testing techniques to sample cases
- Identify control weaknesses in provided scenarios
- Document findings using professional audit methodology
- Recommend control improvements

Deliverables

- Completed control evaluation worksheet
- Risk assessment matrix
- Presentation of key findings (5 minutes per group)

In today's workshop, you'll work in teams to review audit evidence and evaluate the effectiveness of internal controls in a simulated business environment. Focus on identifying both strengths and weaknesses in the control structure.