



Chapter 20

Internal Control



20.10 Internal Control Policies

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20.10.10 Purpose of these policies

July 1, 2017

This chapter provides agency heads, managers, internal control officers, internal auditors, and all other employees, with a background in and approach to establishing and maintaining an effective system of internal control and internal audit so as to reasonably assure that they are meeting their respective objectives.

20.10.20 Authority for these policies

July 1, 2017

The authority for these policies is [RCW 43.88.160\(4\)\(a\)](#).

20.10.30 Applicability of these policies

July 1, 2017

This chapter is applicable to all agencies of the state of Washington, as defined in [RCW 43.88.020\(4\)](#), unless otherwise exempted by statute or rule.

20.10.40 Source of these policies

July 1, 2017

These policies are based on and incorporate information from *Standards for Internal Control in the Federal Government* (Green Book) and *COSO Internal Control - Integrated Framework*.

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20.15 Internal Control Basics

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20.15.10 Internal control definition

July 1, 2017

Internal control is a process, effected by those charged with governance, management, and other employees, designed to provide reasonable assurance regarding the achievement of the entity's objectives relating to operations, reporting, and compliance.

For purposes of Chapter 20, the state's internal control objectives are defined as the need for each agency to:

- Safeguard its assets.
- Check the accuracy and reliability of its accounting data.
- Promote operational efficiency.
- Encourage adherence to policies for accounting and financial controls.

The definition of internal control emphasizes that internal control is:

- Geared to the *achievement of objectives* in one or more separate but overlapping categories - operations, reporting, and compliance.
- *A process* consisting of ongoing tasks and activities - a means to an end, not an end in itself.
- *Effected by people* - not merely about policy and procedure manuals, systems, and forms, but about people and the actions they take at every level of an organization to effect internal control.
- Able to *provide reasonable assurance* - but not absolute assurance, to an entity's management.



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- *Adaptable to the entity structure or size* - flexible in application for the entire entity or for a subset of an entity.

This definition of internal control is intentionally broad. It incorporates concepts that are fundamental to how entities design, implement, and operate a system of internal control and assess its effectiveness.

20.15.20 Roles and responsibilities

July 1, 2017

Agency management is responsible for the agency's operations, compliance and financial reporting objectives. Therefore, the adequacy of internal control to provide reasonable assurance of achieving these objectives is also the responsibility of management. That said, every state employee has a role in effecting internal control. Roles vary in responsibility and level of involvement, as discussed below.

Given agency structure and size, individuals may assume multiple roles. However, care should be taken to address the increased risk that may result from the concentration of responsibilities.

- 20.15.20.a** **Those charged with governance** are responsible for overseeing the strategic direction of the agency and obligations related to the agency's accountability. This includes overseeing the design, implementation, and operation of an effective internal control system. For most agencies, those charged with governance include the agency head and members of agency senior management. For agencies with a governing board, the board may appoint individuals to fulfill this function.
- 20.15.20.b** The **agency head** is ultimately responsible for identifying risks and establishing, maintaining, and monitoring the agency's system of internal control. If the agency head delegates this responsibility, the designated person should have sufficient authority to carry out these responsibilities. The agency head together with those charged with governance and agency management set the tone at the top that affects the control environment in particular and all other components of internal control. The agency head signs the annual Financial Disclosure Certification and, if applicable, the Federal Assistance Certification.
- 20.15.20.c** The **internal control officer (ICO)** is responsible for coordinating the agency-wide effort of evaluating internal control using the guidance in this chapter. The ICO coordinates the agency's required risk assessment and internal control monitoring activities and annually provides written assurance to the agency head as required in [Subsection 20.15.30](#). While each agency is required to have an ICO, the ICO may perform these duties on a full-time basis or on a part-time basis as long as other duties performed are not incompatible with the ICO duties.
- 20.15.20.d** **Agency management** at all levels is responsible for internal control under their span of control. Management is responsible to communicate to agency employees their explicit or implicit control activity duties. In addition, agency management should provide channels outside normal reporting lines so agency employees can report noncompliance, problems in operations, and illegal acts.



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Management is also responsible to convey the importance of internal control to all employees both by what they say and what they do. If management is willing to override controls, then the message that internal control is not important will be conveyed to employees.

- 20.15.20.e** Each agency employee is responsible to be aware of and attentive to risk management and other internal control issues, to consider limitations and key risk areas, to document decisions. To be most effective, employees need to understand the agency's mission, objectives, responsibilities, and their own role in managing risk. Each employee is also responsible to report to management (and through channels outside normal reporting lines when necessary) noncompliance, problems in operations, and illegal acts.
- 20.15.20.f** Other professionals (internal or external to the agency) may provide assurance and advisory support to management in areas such as developing appropriate procedures to conduct risk assessments and internal reviews of control activities.
- 20.15.20.g** External auditors are **not** part of an agency's internal control system and cannot be a replacement for or supplement to an adequate system of internal control. The role of the external auditor is to provide independent accountability and assurance to the public and external stakeholders. However, this independent assurance is also valuable feedback to those charged with governance and agency management.

20.15.30 Annual requirements for agencies related to statewide reporting

July 1, 2017

The Office of Financial Management (OFM) prepares the state's Annual Comprehensive Financial Report (ACFR) annually. While OFM has final responsibility for the contents of the ACFR, the data in the financial statements and many of the notes to the financial statements are generated from Agency Financial Reporting System (AFRS) transactions input by agencies. Because agencies are in control of transactions entered into AFRS, OFM relies on agency internal control systems and the monitoring of those systems to assert in writing that the ACFR is correct and complete.

Additionally, OFM prepares the Statewide Single Audit Report annually. Because federal programs are administered at the agency level, OFM relies on agencies to establish and maintain effective systems of internal control over federal program compliance. OFM relies on agency internal control systems and the monitoring of those systems to assert in writing that the state has materially complied with the provisions of federal programs in order to comply with the *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*.

20.15.30.a Risk assessment and internal control monitoring

At a minimum, agencies are required to document risk assessment and internal control monitoring activities for objectives related to financial reporting and federal program compliance. These activities may be done agency-wide at one time or by sections of the agency over a period of time. The agency



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should consider significance when planning the focus of the risk assessment activities. Likewise, agencies should consider the results of the risk assessment when planning the focus of the monitoring activities. An overall agency plan for risk assessment and internal control monitoring should strive to address high risk areas at least once a biennium.

20.15.30.b Required written annual assurance by the internal control officer

The risk assessment and associated internal control monitoring plan should be designed to provide management with reasonable assurance that controls are operating as expected. The plan should also be used to determine if internal control modifications are needed by considering events that have occurred, processes or procedures that have changed, new projects or programs that are being planned or implemented, and other changes within the agency that may have additional risks. If the plan uncovers internal control weaknesses or if prior weaknesses still exist, they should be documented and addressed in a timely manner.

The internal control officer is to communicate to the agency head the results of the agency's required risk assessment and associated internal control monitoring process. The communication is to include a summary of all known weaknesses in internal control that could have a material effect on financial reporting and federal program compliance along with the related corrective action or recommendations. This communication may be ongoing and informal, but at least once per year, this assurance must be made in writing to the agency head.

The internal control officer is responsible for ensuring that the plan is followed and that required documentation of the risk assessment and monitoring conclusions is maintained and available for review by agency management, the State Auditor's Office, and OFM.

20.15.30.c Required annual certifications signed by the agency head and CFO

As evidence that OFM can rely on each agency's internal control systems for statewide reporting purposes, every agency head and chief financial officer (CFO) is required to annually sign and submit a Financial Disclosure Certification and, if applicable, a Federal Assistance Certification, to OFM's Accounting Division. By signing the certification(s), the agency head and CFO certify that:

- We are responsible for and have established and maintained an effective system of internal controls as prescribed by SAAM Chapter 20. Our agency's system of internal controls incorporates adequate procedures and controls to safeguard our assets, check the accuracy and reliability of our accounting data, promote operational efficiency, and encourage adherence to policies for accounting and financial controls. If there are significant deficiencies in internal control, a summary of the deficiencies and corrective action is **attached** to this state certification.
- We are responsible for the design and implementation of programs and controls to prevent and detect fraud. We have disclosed all known instances and allegations of fraud or suspected fraud involving management and employees who have significant roles in internal control. We have also disclosed on this state certification any known instances and allegations of fraud or suspected fraud involving others where the fraud could have a material effect on the financial statements.



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- If applicable, we are responsible for and have established and maintained an effective system of internal control over federal program compliance, providing reasonable assurance that federal awards are managed in compliance with laws, regulations, and the provisions of contracts and grant agreements that could have a material effect on those programs. If there are significant deficiencies in internal control, a summary of the deficiencies and corrective action is attached to this federal certification.

There can be a variety of evidence that an agency head and CFO use as support backup for signing the certifications referred to above, including the required annual assurance.

20.15.40 Internal control components and principles

July 1, 2017

The following five components and 17 principles together represent a comprehensive system of internal control. This subsection presents a summary of each of the five components and the principles relating to each component. For further details, refer to each component's section.

20.15.40.a Control environment

The control environment is the set of standards, processes, and structures that provide the foundation for carrying out internal control across the agency. The agency head together with those charged with governance and agency management set the tone at the top regarding the importance of internal control and expected standards of conduct.

There are five principles relating to the control environment.

1. The agency head together with those charged with governance and agency management demonstrate commitment to integrity and ethical values.
2. Those charged with governance oversee the development and performance of internal control.
3. Management establishes structures, reporting lines, and appropriate authorities and responsibilities in pursuit of objectives.
4. Management demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.
5. Management holds individuals accountable for their internal control responsibilities in the pursuit of objectives.

20.15.40.b Risk assessment

Risk assessment involves a dynamic and iterative process for identifying and analyzing risks to achieving the agency's objectives, analyzing the risks, and using that information to decide how to respond to the risks.



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There are four principles relating to risk assessment.

6. Management specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to its objectives.
7. Management identifies and analyzes risks to the achievement of its objectives and uses that as a basis for determining how the risks should be managed.
8. Management considers the potential for fraud in assessing risks to the achievement of its objectives.
9. Management identifies, analyzes, and responds to changes that could significantly impact its system of internal control.

20.15.40.c Control activities

Control activities are policies, procedures, techniques, and mechanisms that help ensure that risks to the achievement of an agency's objectives are mitigated. Control activities are performed at all levels of the agency, at various stages within business processes, and over the technology environment.

There are three principles relating to control activities.

10. Management designs control activities to achieve its objectives and respond to risks.
11. Management designs its information systems and related control activities to achieve its objectives and respond to risks.
12. The agency implements control activities through policies and procedures.

20.15.40.d Information and communication

Information and communication are necessary for an agency to carry out its internal control responsibilities to support the achievement of its objectives.

There are three principles relating to information and communication.

13. The agency obtains or generates and uses relevant, quality information to support the functioning of internal control.
14. The agency internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of internal control.
15. The agency communicates with external parties regarding matters affecting the functioning of internal control.

20.15.40.e Monitoring Activities

Monitoring is the process of evaluating the quality of internal control performance over time and promptly addressing internal control deficiencies.



There are two principles relating to monitoring activities.

16. Management establishes and performs activities to monitor the internal control system and evaluate the results.
17. The agency evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action.

20.15.50 Limitations of internal control

July 1, 2017

No matter how well designed, implemented, and conducted, internal control can provide only *reasonable assurance* that objectives will be achieved due to limitations inherent to any system. These limitations include the following:

20.15.50.a Judgment

The effectiveness of controls is limited by the fact decisions must be made with human judgment based on the person's experience and qualifications, in the time available, the information available, and pressures to conduct business.

Clear written policies and instructions, redundant controls, and effective monitoring may address this limitation in some instances.

20.15.50.b External events

Achieving operational objectives may be limited by factors outside the agency's control, such as federal regulations, responsiveness of customers or program partners, and natural disasters. However, internal control should at least allow the agency to be informed of progress, or lack thereof, toward achieving such objectives.

Effective risk assessment may address this limitation in some instances.

20.15.50.c Breakdowns

A well-designed system of internal control can break down due to misunderstanding instructions, obsolete technology, faulty assumptions, mistakes due to carelessness, distraction, or being asked to focus on too many tasks.

Effective risk assessment and monitoring, automated controls and redundant controls may address this limitation in some instances.

20.15.50.d Management override

Even in an agency with an effective system of internal control, high-level employees may be able to override prescribed policies or procedures for personal gain or advantage. This should not be confused



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with management intervention, which represents management actions to depart from prescribed policies or procedures for legitimate purposes.

An internal audit function reporting to those charged with governance or a communication channel to allow anonymous or confidential communication, such as the statewide whistleblower program, may address this limitation in some instances.

20.15.50.e Collusion

Collusion between two or more individuals can result in control failures. Individuals acting collectively often can alter financial data or other management information in a manner that cannot be identified by the control system.

Effective monitoring and redundant controls may address this limitation in some instances. – Collusion between two or more individuals can result in control failures. Individuals acting collectively often can alter financial data or other management information in a manner that cannot be identified by the control system.

Effective monitoring and redundant controls may address this limitation in some instances.

20.15.50.f Resource limitations

Every agency must prioritize efforts to implement or improve controls within resource limitations.

20.15.60 Other considerations

July 1, 2017

There are many ways to achieve effective internal control. Management must use judgment in determining the specific combination of controls and how such controls are implemented, based on the agency's statutory purposes, regulations, programs, size, organizational structure, program structure, technology, staffing, and policies. Thus, while all agencies must have sufficient internal control, the specific controls in place will vary.

20.15.60.a Large versus small agencies

All components and principles apply to both large and small agencies. However, smaller agencies may have different implementation approaches than larger agencies. Smaller agencies typically have unique advantages, which can contribute to an effective internal control system. These may include a higher level of involvement by management in operational processes and direct interaction with employees.

A smaller agency, however, may face greater challenges in segregating duties because of its concentration of responsibilities and authorities in the organizational structure. Management, however, can respond to this increased risk through the design of the internal control system, such as by adding additional levels of review for key operational processes, reviewing randomly selected transactions and related supporting documentation, taking periodic asset counts, or checking supervisor reconciliations.



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20.15.60.b Benefits and costs of internal controls

When designing internal controls, management should balance the cost of different control approaches with expected benefits. The allocation of resources should address the areas of greatest risk, complexity, or other factors relevant to achieving the agency's objectives.

20.15.60.c Service organizations

Management may engage external third parties to perform certain operational processes for the agency, such as accounting and payroll processing, security services, or social service and health care claims processing. These external third parties are referred to as service organizations. Management, however, retains responsibility for the performance of processes assigned to service organizations. Internal control over contracted processes may be attained either with controls performed by the agency, reliance on controls performed by the service organization, or a combination of both. To the extent the agency relies on controls performed by the service organization, the agency needs to obtain appropriate written assurance from the service organization and to arrange for periodic independent review of these controls.

20.15.60.d Documentation

Documentation is a necessary part of a system of internal control. Management must determine the level and nature of documentation that is needed to assess the effectiveness of internal control. Documentation should be sufficient to allow the agency to:

- Assess the overall soundness of the system of internal control.
- Be aware of the existence of internal control weaknesses, if any.
- Formulate the agency's plan of action for addressing internal control weaknesses and improving the internal control where necessary.



20.20 Control Environment

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20.20.10 Control environment overview

July 1, 2017

The control environment is the set of standards, processes, and structures that provide the foundation for carrying out internal control across the agency. The agency head together with those charged with governance and agency management set the tone at the top regarding the importance of internal control and expected standards of conduct.

Management reinforces expectations at all levels of the agency. The control environment has a pervasive impact on the overall system of internal control.

20.20.20 Control environment principles

July 1, 2017

There are five principles relating to the control environment.

1. The agency head together with those charged with governance and agency management demonstrate commitment to integrity and ethical values.
2. Those charged with governance oversee the development and performance of internal control.



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3. Management establishes structures, reporting lines, and appropriate authorities and responsibilities in pursuit of objectives.
4. Management demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.
5. Management holds individuals accountable for their internal control responsibilities in the pursuit of objectives.

20.20.30 Management's role in the control environment

July 1, 2017

Management is very influential in determining the control environment and influencing the control consciousness of agency employees. A system of internal control is likely to function well if management believes that controls are important and communicates that view to employees at all levels. Conversely, a system of internal control is likely to be ineffective if management does not believe the controls are important or if management communicates a negative view of controls to employees.

Management influences the control environment through their integrity and ethical values, commitment to competence, philosophy and operating style, design of the organizational structure, assignment of authority and responsibilities, and human resource policies and practices.

Management also influences the control environment through communication of the agency's values and behavioral standards to employees. This can be done by setting a good example, showing a positive attitude toward internal control, displaying and following a formal code of conduct, communicating other agency policies and procedures, taking swift and appropriate disciplinary action in response to policy departure, and maintaining clear and updated job descriptions.

20.20.40 Principle 1 – Demonstrates commitment to integrity and ethical values

July 1, 2017

The agency head together with those charged with governance and agency management demonstrate commitment to integrity and ethical values. The following points of focus highlight important characteristics relating to this principle:

- **Set the tone at the top and throughout the agency** - The agency head together with those charged with governance and agency management at all levels of the agency demonstrate through their directives, actions, and behavior the importance of integrity and ethical values to support the functioning of the system of internal control.
- **Establish standards of conduct** - The expectations of the agency head together with those charged with governance and senior management concerning integrity and ethical values are defined in the agency's standards of conduct and understood at all levels of the agency.



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- **Evaluate adherence to standards of conduct** - Processes are in place to evaluate the performance of individuals and teams against the agency's expected standards of conduct.
- **Address deviations in a timely manner** - Deviations of the agency's expected standards of conduct are identified and remedied in a timely and consistent manner.

20.20.50 Principle 2 – Exercises oversight responsibility

July 1, 2017

Those charged with governance oversee the development and performance of internal control. The following points of focus highlight important characteristics relating to this principle:

- **Determine an oversight structure** - Those charged with governance determine an oversight structure to fulfill responsibilities set forth by applicable laws and regulations, relevant government guidance, and feedback from key stakeholders.
- **Provide oversight** - Those charged with governance oversee management's design, implementation, and operation of the agency's internal control system.
- **Provide input for remediation** - Those charged with governance give input to management's plans for remediation of deficiencies in the internal control system as appropriate.

20.20.60 Principle 3 – Establishes structures, reporting lines, authorities, and responsibilities

July 1, 2017

Management establishes structures, reporting lines, and appropriate authorities and responsibilities in pursuit of objectives. The following points of focus highlight important characteristics relating to this principle.

- **Establishes the organizational structure** - Management establishes the organizational structure that enables the agency to achieve its objectives and address related risks.
- **Establishes reporting lines** - Management designs and evaluates lines of reporting to enable execution of authorities and responsibilities and flow of information to manage the activities of the agency.
- **Assigns responsibility and delegates authority** - To achieve the agency's objectives, the agency head assigns responsibility and delegates authority to key roles throughout the agency. A key role is a position in the organizational structure that is assigned an overall responsibility of the agency. Generally, key roles relate to senior management positions within an agency.



20.20.70 Principle 4 – Demonstrates commitment to competence

July 1, 2017

Management demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives. The following points of focus highlight important characteristics relating to this principle:

- **Establishes policies and practices** - Management develops policies and practices that reflect expectations of competence necessary to support the achievement of objectives.
- **Evaluates competence and addresses shortcomings** - Management evaluates competence of agency employees and of outsourced service providers in relation to established policies and practices, and acts as necessary to address shortcomings. Those charged with governance evaluate competence of management.
- **Attracts, develops, and retains individuals** - Management provides the mentoring and training needed to attract, develop, and retain employees to support achievement of objectives.
- **Plans and prepares for succession** - Management develops contingency plans for assignments of responsibility important for internal control.

20.20.80 Principle 5 – Enforces accountability

July 1, 2017

Management holds individuals accountable for their internal control responsibilities in the pursuit of objectives. The following points of focus highlight important characteristics relating to this principle

- **Enforces accountability through structures, authorities, and responsibilities** - Management establishes the mechanisms to communicate and hold individuals accountable for performance of internal control responsibilities across the agency.
- **Establishes expectations and evaluates performance** - Management establishes expectations appropriate for and evaluates performance related to internal control responsibilities.
- **Considers excessive pressures** - Management evaluates and manages pressures associated with the achievement of objectives when assigning responsibilities, developing expectations, and evaluating performance.



20.22 Risk Assessment

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20.22.10 Risk assessment overview

July 1, 2017

Risk is defined as the possibility that an event will occur and adversely affect the achievement of objectives. Therefore, a precondition to risk assessment is establishing objectives. Risk assessment involves a dynamic and iterative process for identifying risks to achieving agency objectives, analyzing the risks, and using that information to decide how to respond to risks.

In risk assessment, management considers the mix of potential events relevant to the agency and its activities in the context of the agency's public visibility, size, operational complexity, regulatory restraints, and other factors. Because of these variables, the same activity could have very different levels of risk for two different agencies.

20.22.20 Risk assessment principles

July 1, 2017

There are four principles relating to risk assessment.

6. Management specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to its objectives.
7. Management identifies and analyzes risks to the achievement of its objectives and uses that as a basis for determining how the risks should be managed.
8. Management considers the potential for fraud in assessing risks to the achievement of its objectives.



9. Management identifies, analyzes, and responds to changes that could significantly impact its system of internal control.

20.22.30 Principle 6 – Specifies objectives

July 1, 2017

Management specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to its objectives. The following points of focus highlight important characteristics relating to this principle.

- **Defines specific and measurable objectives** - Management defines objectives at the agency and unit level in alignment with the agency's mission and strategic plan. Objectives:
 - Are fully and clearly set forth so they can be easily understood at all levels of the agency.
 - Can be broadly classified into one or more of three categories: operations, reporting, or compliance
 - Are stated in a quantitative or qualitative form that permits reasonably consistent measurement.
- **Considers external and internal factors** - Management considers external requirements and internal expectations when defining objectives to enable the design of internal control. Legislators, regulators, and standard-setting bodies set external requirements by establishing the laws, regulations, and standards with which the agency is required to comply. Management sets internal expectations and requirements by establishing standards of conduct, assigning responsibility, and delegating authority.
- **Considers risk tolerance** - Management considers risk tolerances for the defined objectives. Risk tolerance is the acceptable level of variation in performance relative to the achievement of objectives.

20.22.40 Principle 7 – Identifies and analyzes risks

July 1, 2017

Management identifies and analyzes risks to the achievement of its objectives and uses that as a basis for determining how the risks should be managed. The following points of focus highlight important characteristics relating to this principle.

- **Identifies risk** - Management identifies risks throughout the agency relevant to the achievement of its objectives, considering both internal and external factors. Management considers the types of risks that impact the agency which may include both inherent and residual risk. Management's lack of response to risk could cause deficiencies in the internal control system.

Management considers significant interactions within the agency and with external parties, changes within the agency's internal and external environment, and other internal and external factors to identify risks. Internal risk factors may include the complex nature of an agency's



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programs, its organizational structure, or the use of new technology in operational processes. External risk factors may include new or amended laws, regulations, or professional standards; economic instability; or potential natural disasters.

- **Analyzes risks** - Management analyzes identified risks to estimate their significance, which provides a basis for responding to the risks. Management estimates the significance of a risk by considering the magnitude of impact and likelihood of occurrence.

Magnitude of impact refers to the likely magnitude of deficiency that could result from the risk and is affected by factors such as the size, pace, and duration of the risk's impact. Likelihood of occurrence refers to the level of possibility that a risk will occur.

- **Manages risk** - Management considers how the risk should be managed. Management designs overall risk responses based on the significance of the risk and defined risk tolerance. Risk responses may include the following:
 - **Acceptance** - No action is taken to respond to the risk based on the magnitude of impact, likelihood of occurrence, and nature of the risk.
 - **Avoidance** - Action is taken to stop the operational process or the part of the operational process causing the risk.
 - **Reduction** - Action is taken to reduce the likelihood or magnitude of the risk.
 - **Sharing** - Action is taken to transfer or share risks across the agency or with external parties, such as insuring against losses.

Typically, no control activities are needed for acceptance and avoidance responses. When risk response actions do not enable the agency to operate within its risk tolerances, management may need to revise risk responses or reconsider risk tolerances. Periodic risk assessments allow management to evaluate the effectiveness of the risk response actions.

20.22.50 Principle 8 – Assesses fraud risk

July 1, 2017

Management considers the potential for fraud in assessing risks to the achievement of its objectives. The following points of focus highlight important characteristics relating to this principle.

- **Considers various types of fraud** - Management considers the types of fraud that can occur within the agency to provide a basis for identifying fraud risks, such as:
 - **Fraudulent financial reporting** - Intentional misstatements or omissions of amounts or disclosures in financial reporting to deceive users of the financial information. This could include intentional alteration of accounting records, misrepresentation of transactions, or intentional misapplication of accounting principles.
 - **Misappropriation of assets** - Theft or misuse of an agency's assets. This could include theft of property, misuse of data, embezzlement of receipts, or fraudulent payments.



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- **Corruption** - Bribery and other illegal acts, such as the misuse of authority or position for personal gain or for the benefit of another.
- **Considers fraud risk factors** - Fraud risk factors do not necessarily indicate that fraud exists but are often present when fraud occurs. Management considers fraud risk factors which include the following:
 - **Incentive/pressure** - Management or other personnel have an incentive or are under pressure, which provides a motive to commit fraud.
 - **Opportunity** - Circumstances exist, such as the absence of controls, ineffective controls, or the ability of management to override controls, that provide an opportunity to commit fraud.
 - **Attitude/rationalization** - Individuals involved are able to rationalize committing fraud. Some individuals possess an attitude, character, or ethical values that allow them to knowingly and intentionally commit a dishonest act.

While fraud risk may be greatest when all three risk factors are present, one or more of these factors may indicate a fraud risk. Other information provided by internal and external parties can also be used to identify fraud risks. This may include allegations of fraud or suspected fraud reported by an internal auditor, employees, or external parties that interact with the agency.

- **Responds to fraud risk** - Management analyzes and responds to fraud risks using the same process performed for all risks so they are effectively mitigated. Refer to Principle 7 in [Subsection 20.22.40](#).

20.22.60 Principle 9 – Identifies, analyzes, and responds to changes

July 1, 2017

Management identifies, analyzes, and responds to changes that could significantly impact its system of internal control. The following points of focus highlight important characteristics relating to this principle.

- **Identifies changes** - The risk identification process considers changes in:
 - **The external environment** which includes the regulatory, economic, technological, legal, and physical environment in which the agency operates.
 - **The business model** due to new technologies, rapid growth, legislation, and other factors.
 - **Leadership** which could lead to changes in management attitudes and philosophies on the system of internal control.
- **Analyzes and responds to changes** - Because changing conditions may prompt new risks or changes to existing risks, management analyzes and responds to identified changes that could significantly impact its system of internal control in order to maintain its effectiveness. Management analyzes and responds to changes using the same process performed for all risks so they are effectively mitigated. Refer to Principle 7 in [Subsection 20.22.40](#).



20.24 Control Activities

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20.24.10 Control activities overview

July 1, 2017

Control activities are policies, procedures, techniques, and mechanisms that help ensure that risks to the achievement of an agency’s objectives are mitigated. Control activities are performed at all levels of the agency, at various stages within business processes, and over the technology environment. They may be preventive or detective in nature. Preventive controls are designed to deter the occurrence of an undesirable event by implementing procedures to avoid them. Detective controls are designed to identify undesirable events that do occur and alert management about what has happened.

When designing and implementing control activities, management should consider cost versus benefit and the likelihood and impact of the associated risk. Building control activities into business processes and systems as they are being designed is generally more cost-effective than adding them later.

20.24.20 Control activities principles

July 1, 2017

There are three principles relating to control activities.

10. Management designs control activities to achieve its objectives and respond to risks.
11. Management designs its information systems and related control activities to achieve its objectives and respond to risks.
12. The agency implements control activities through policies and procedures.



20.24.30 Principle 10 – Designs control activities

July 1, 2017

Management designs control activities to achieve its objectives and respond to risks. The following points of focus highlight important characteristics relating to this principle.

- **Integrates with risk assessment** - Control activities help ensure that risk responses that address and mitigate risks are carried out.
- **Considers agency-specific factors** - Control activities address the environment, complexity, nature, and scope of operations, as well as the specific characteristics of the agency.
- **Evaluates a mix of control activity types** - Control activities include a range and variety of controls and may include a balance of approaches to mitigate risks, considering both manual and automated controls, and preventive and detective controls.
- **Considers at what level activities are applied** - Control activities are applied at various levels in the agency.
- **Addresses segregation of duties** - Where segregation of duties is not practical, appropriate alternate control activities are utilized.

20.24.40 Principle 11 – Designs information systems and related control activities

July 1, 2017

Management designs its information systems and related control activities to achieve its objectives and respond to risks, taking into consideration Office of the Chief Information Officer policies as applicable. The following points of focus highlight important characteristics relating to this principle.

- **Designs information systems and appropriate control activities** - Management designs (1) its information system to obtain, store, and process quality information and (2) appropriate control activities including defining responsibilities, assigning them to key roles, and delegating authority.
- **Establishes relevant technology infrastructure control activities** - Management selects and implements control activities over the technology infrastructure, which are designed to help ensure the completeness, accuracy, and availability of technology processing.
- **Establishes relevant security control activities** - Management selects and implements control activities that are designed to restrict technology access rights to authorized users commensurate with their job responsibilities and to prevent unauthorized use of and changes to the agency's information system.
- **Establishes relevant technology control activities** - Management selects and implements control activities over the acquisition, development, and maintenance of technology assets.



20.24.50 Principle 12 – Implements control activities through policies and procedures

July 1, 2017

The agency implements control activities through policies and procedures. The following points of focus highlight important characteristics relating to this principle.

- **Establishes policies and procedures to achieve its objectives and respond to risks** - The agency establishes policies and procedures that (1) assign responsibility for operational objectives and related risks and (2) incorporate control activities. Policies and procedures may address the timing of when a control activity occurs and any follow up corrective actions to be performed by competent employees if deficiencies are identified.
- **Reassesses policies and procedures** - The agency periodically reviews policies, procedures, and related control activities for continued relevance and effectiveness, and refreshes them when necessary.



20.26 Information and Communication

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20.26.10 Information and communication overview

July 1, 2017

Information and communication are necessary for an agency to carry out its internal control responsibilities to support the achievement of its objectives. Management uses relevant and quality information from both internal and external sources to support the functioning of internal control.

Communication is the continual, iterative process of obtaining and sharing necessary information.

- **Internal communication** is the means by which information is disseminated throughout the agency, flowing up, down, and across the agency.
- **External communication** enables incoming communication of relevant external information and provides information to external parties in response to requirements and expectations.

20.26.20 Information and communication principles

July 1, 2017

There are three principles relating to information and communication.

13. The agency obtains or generates and uses relevant, quality information to support the functioning of internal control.
14. The agency internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of internal control.
15. The agency communicates with external parties regarding matters affecting the functioning of internal control.



20.26.30 Principle 13 – Uses relevant information

July 1, 2017

The agency obtains or generates and uses relevant, quality information to support the functioning of internal control. The following points of focus highlight important characteristics relating to this principle.

- **Identifies information requirements** - Management designs a process that uses the agency's objectives and related risks to identify the information requirements needed to achieve the objectives and address the risks. Information requirements consider the needs of both internal and external users. Management defines the information requirements and relevant level of specificity for all users.

Management identifies information requirements in an iterative and ongoing process that occurs throughout an effective internal control system. As change in the agency and its objectives and risks occurs, management changes information requirements as needed to meet these modified objectives and address these modified risks.

- **Captures relevant data from reliable sources** - Management obtains relevant data from reliable internal and external sources in a timely manner based on the identified information requirements. Relevant data have a logical connection with, or bearing upon, the identified information requirements. Reliable internal and external sources provide data that are reasonably free from error and bias and faithfully represent what they purport to represent.

Management evaluates both internal and external sources of data for reliability. Sources of data can be operational, financial, or compliance related. Management obtains data on a timely basis so that they can be used for effective monitoring.

- **Processes data into information** - Management processes the obtained data into quality information that supports the internal control system. Quality information is appropriate, current, complete, accurate, accessible, and provided on a timely basis. Management uses the quality information to make informed decisions and evaluate the agency's performance in achieving key objectives and addressing risks.

20.26.40 Principle 14 – Communicates internally

July 1, 2017

The agency internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of internal control. The following points of focus highlight important characteristics relating to this principle.

- **Communicates internal control information** - A process is in place to communicate required information to enable all employees to understand and carry out their internal control responsibilities.



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- **Communicates with those charged with governance** - Communication exists between management and those charged with governance so that both have information needed to fulfill their roles with respect to the agency's objectives.
- **Provides separate communication lines** - Separate communication channels are in place and serve as fail-safe mechanisms to enable anonymous or confidential communication when normal channels are inoperative or ineffective. For example, management may have formal or informal channels in addition to the statewide whistleblower program.
- **Selects relevant methods of communication** - The methods of communication consider the timing, audience, and nature of the information.

20.26.50 Principle 15 – Communicates externally

July 1, 2017

The agency communicates with external parties regarding matters affecting the functioning of internal control. The following points of focus highlight important characteristics relating to this principle.

- **Communicates to external parties** - Processes are in place to communicate relevant and timely information to external parties. External parties include other agencies, regulators, customers and suppliers, financial analysts, external auditors, and the general public.
- **Enables incoming communications** - Open communication channels allow input from external parties, providing management and those charged with governance with relevant information.
- **Communicates with the oversight body** - Information resulting from assessments conducted by external parties is communicated to the oversight body.
- **Provides separate communication lines** - Separate communication channels are in place and serve as fail-safe mechanisms to enable anonymous or confidential communication to supplement normal channels. For example, management may have formal or informal channels in addition to the statewide hotline program.
- **Selects relevant method of communication** - The method of communication considers the timing, audience, cost, nature of the communication and legal, regulatory, and fiduciary requirements and expectations.



20.28 Monitoring

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20.28.10 Monitoring overview

July 1, 2017

Monitoring is the process of evaluating the quality of internal control performance over time and promptly addressing internal control deficiencies. Monitoring can take the form of ongoing evaluations, which are built into business processes at different levels of the agency, or separate evaluations, which are conducted periodically and vary in scope and frequency, depending on assessment of risks, effectiveness of ongoing evaluations, and other management considerations.

Monitoring of the internal control system is essential in helping internal control remain aligned with changing objectives, environment, laws, resources, and risks.

20.28.20 Monitoring principles

July 1, 2017

There are two principles relating to monitoring activities.

16. Management establishes and performs activities to monitor the internal control system and evaluate the results.
17. The agency evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action.



20.28.30 Monitoring versus control activities

July 1, 2017

It can be difficult to distinguish between a review that is a control activity and one that is a monitoring activity. Some judgment is involved but determining the intent of the activity can help. An activity designed to detect and correct errors is likely a control activity, while an activity designed to ask why there were errors in the first place and assign responsibility for fixing the process to prevent future errors is likely a monitoring activity. In other words, a control activity responds to a specific risk, while a monitoring activity assesses whether controls within each of the five components of internal control are operating as intended.

20.28.40 Principle 16 – Performs monitoring activities

July 1, 2017

Management establishes and performs activities to monitor the internal control system and evaluate the results. The following points of focus highlight important characteristics relating to this principle.

- **Establishes a baseline** - Management establishes a baseline to monitor the internal control system. The baseline represents the difference between the criteria of the design of the internal control system and condition of the internal control system at a specific point in time.
- **Monitors the internal control system** - Management performs ongoing monitoring of the design and operating effectiveness of the internal control system as part of the normal course of operations.
- **Evaluates the results** - Management evaluates and documents the results of ongoing monitoring and separate evaluations to identify internal control issues. Separate evaluations may take the form of self-assessments, which include cross operating unit or cross functional evaluations. Separate evaluations also include audits and other evaluations that may involve the review of control design and direct testing of internal control.

20.28.50 Principle 17 – Evaluates and communicates deficiencies

July 1, 2017

The agency evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action, including those charged with governance and agency management, as appropriate. The following points of focus highlight important characteristics relating to this principle.

- **Communicates deficiencies** - Deficiencies are communicated to parties responsible for taking corrective action, including those charged with governance and agency management, as appropriate. In certain circumstances, deficiencies are also communicated to the State Auditor's



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Office refer to [Subsection 70.75](#) and the Office of Financial Management on the Annual Financial Disclosure Certification. Refer to [Subsection 90.40.95](#).

- **Assesses deficiencies** - Management evaluates and documents internal control issues and, on a timely basis, determines appropriate corrective action for internal control deficiencies.
- **Documents and implements corrective action** - Management documents corrective action to remediate internal control deficiencies. Corrective action includes resolution of audit findings. Depending on the nature of a deficiency, either those charged with governance or agency management oversee its prompt remediation by communicating the corrective action to the appropriate level of the organizational structure and delegating authority for completing corrective action to appropriate employees.