

Evaluation of Controls

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Evaluation of Controls in the International Professional Practices Framework

The International Professional Practices Framework (IPPF), promulgated by the Institute of Internal Auditors, details the role of internal auditing ⁽¹⁾ in evaluating the controls in all automated and manual processes, activities, and systems which altogether form the internal control system in an organization.⁽²⁾ The internal audit activity may evaluate the controls either through assurance engagements or consulting engagements. In this article, I will present what the IPPF stated regarding internal controls auditing. This content will be helpful for auditors to provide added value to their work in this regard.

I: Internal Audit Role in the Evaluation of Controls

The IPPF standard No. 2021 - Planning *Considerations*, stipulates that in planning the engagement, internal auditors must consider:

- *The adequacy and effectiveness of control processes compared to a relevant framework or model;*
- **The opportunities for making significant improvements to the control processes.**

Moreover, the IPPF standard No 2130 -*Controls*, stipulates that *the internal audit activity must assist the organization in maintaining effective controls by evaluating their effectiveness and efficiency and by promoting continuous improvement.*

(1) The word “activity” was used because an independent unit or department within the organization, by an external party through (outsourcing), or a combination of both may provide internal auditing services.

(2) The IIA defines controls as any action taken by management, the board, and other parties to manage risk and increase the likelihood that established objectives and goals will be achieved

Standard No 2130.A1 ⁽³⁾ states that *the internal audit activity must evaluate the adequacy and effectiveness of controls in responding to risks within the organization's governance, operations and information systems regarding the achievement of the organization's strategic objectives, reliability and integrity of financial and operational information, effectiveness and efficiency of operations and programs, safeguarding of assets, compliance with laws, regulations, policies, procedures, and contracts.* The IPPF standard No 2130.C1 ⁽⁴⁾, stipulates that *Internal auditors must incorporate knowledge of controls gained from consulting engagements into evaluation of the organization's control processes.*

II: The Most Significant Considerations in the Evaluation of Controls

The implementation guidance states that internal auditors must:

- (1) Have a clear understanding of the control concept and the characteristic of model control processes;
- (2) Discuss with the senior management and the board to define the risk appetite⁽⁵⁾, tolerance, and culture in the organization.
- (3) Understand the critical risks that may hinder the organization's ability to achieve its goals, and understand the nature of controls implemented to mitigate the risks and reduce them to an acceptable level.
- (4) Obtain an accurate understanding of the control frameworks that are formally or informally approved by the organization as well as the internationally accepted comprehensive control frameworks such as the internal control framework, the integrated framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)⁽⁶⁾.
- (5) Understand the responsibilities relevant to the maintenance of effective controls;
- (6) Consult the legal department of the organization, the compliance officer, or other relevant parties about the laws and regulations to which the organization must comply. It is important to understand how to keep the organization updated with the changes in the regulatory requirements to ensure compliance.

In addition, the implementation guidance includes some points the internal audit activity may implement to enhance the control effectiveness in the organization:

- (1) Preparation of a comprehensive evaluation of the organization's controls;
- (2) Recommending the application of a control framework if the organization doesn't apply a framework;

⁽³⁾ An implementation standard for assurance engagements.

⁽⁴⁾ An implementation standard for consulting engagements.

⁽⁵⁾ The IIA defines the risk appetite as the level of risk an organization is willing to take.

⁽⁶⁾ In the internal control framework - the integrated framework, promulgated by COSO, "the organization's compliance with the applicable laws and regulations and the compliance of all the staff of the organization with all the regulations, systems, and policies approved by the highest governance body in the organization" is considered as one of the three internal control objectives. Furthermore, the compliance and other internal control activities in the framework are considered as one of the five elements of the framework (monitoring activities).

- (3) Recommending steps to enhance the control environment (for example, the senior management's approach (the tone at the top) to enhance ethical conduct and intolerance to non-compliance);
- (4) Providing the needed training on controls and ongoing self-monitoring;
- (5) For the management of the organization, facilitating holding sessions for self-monitoring of controls (or risks and controls);
- (6) Helping the management in establishing a logical structure to document, analyze, and evaluate the organization's design of the control processes;
- (7) Helping in developing a process to define, evaluate, and address the defects in controls;
- (8) Helping the management in keeping pace with the recent issues, laws, and regulations relevant to controls; and
- (9) Being updated with the technological advances that may help in monitoring the efficiency and effectiveness of controls.

Based on the above, the internal audit role in the evaluation of controls mainly focuses on the controls' effectiveness⁽⁷⁾, efficiency⁽⁸⁾, and adequacy.⁽⁹⁾

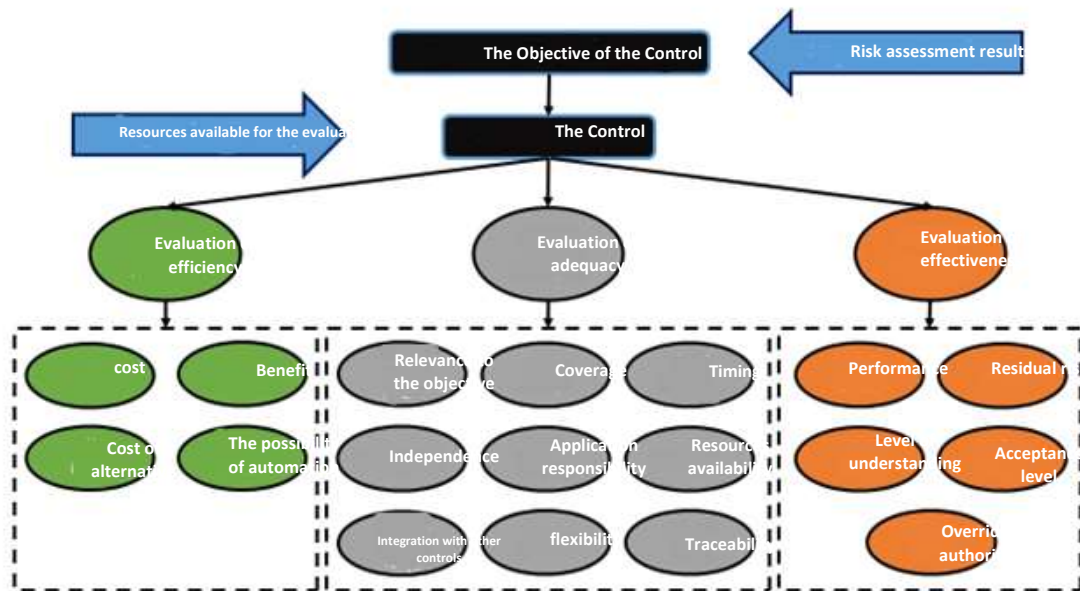
How to Evaluate the Controls?

(7) An **effective** control is a control that successfully accomplish its intended purpose of minimizing potential threats and their implications. To determine the effectiveness of a control, factors such as its impact on mitigating inherent risks, the level of management's comprehension and recognition of the control's significance, and any other factors that may impact its effectiveness are all evaluated.

(8) An **efficient** control is a control that uses the minimum amount of resources without affecting the effectiveness of its intended purpose. To evaluate the efficiency of a control, for example, a cost-benefit analysis is conducted of the control, the alternatives, and other issues that may affect the efficiency of the control.

(9) An **adequate** control is a control that exists in its adequate location in a process or system. It is the control adopted by the competent person in the adequate timing and location with the adequate form, coverage, flexibility, and other issues that may affect the adequacy of the control.

The following diagram shows the most prominent points that should be considered in evaluating the effectiveness, efficiency, and adequacy of a control:



The following are examples of the points stated in the above diagram:

- (1) Automated controls are more efficient than manual controls;
- (2) Simple controls (for example, those that require one procedure or a single calculation) is more efficient and effective than complex controls (for example, those that require many procedures or calculations);
- (3) The control that is implemented by an expert employee is more efficient than that implemented by an employee with low experience;
- (4) A preventive control is more adequate than a detective control;
- (5) A control over each process is more adequate than a control over a sample of processes;
- (6) The control accompanying the processes or the entry is more adequate and efficient than the control subsequent to the process or entry;
- (7) The control that is implemented by an employee other than the one responsible for the process is more efficient than the control implemented by the employee responsible for the process;
- (8) The control that is implemented by an employee from another department is more efficient than the control implemented by an employee, other than the one responsible for the process, from the same department;

The Controls location in the Risk Response Strategies

In the risk management processes, the organization responds to risks, specifically the adverse risks (threats) through 4 strategies that should be implemented consecutively to attain an acceptable level of risk. These strategies are:

- (1) **Avoidance:** This strategy includes the following alternatives, for example: Divest, prohibit, stop, target, screen for alternatives, eliminate, etc.
- (2) **Reduction:** This strategy includes the following alternatives, for example: Control, disperse, isolate, test, relocate, redesign, diversity, etc.
- (3) **Transfer:** This strategy includes the following alternatives, for example: Insure, reinsure, hedge, securitize, outsource, indemnify, etc.
- (4) **Acceptance:** This strategy includes the following alternatives, for example: Self-insure, retain, offset, reprice, etc.

Based on the above, controls are similar regarding risk response strategies. This strategy is not the only or preferred in mitigating adverse threats by reducing the possibility of occurrence and/or implications.

Conclusion

The IIA defines controls as the actions taken by management, the board, and other parties to manage risk and increase the likelihood that established objectives and goals will be achieved. Since controls are associated with risks, and risks by their very nature are dynamic, I believe that controls should be regularly revised and updated to respond to the changes in the external and internal environment of an organization.

While internal control may be executed by specific individuals, it is the responsibility of every member of the organization to ensure its implementation. However, the ultimate responsibility for controls lies with the board and senior management. A good internal control system is geared towards reaching the goals of the organization on multiple levels. It should be seen as a method of achieving a specific objective, rather than an end in itself.

Finally, internal control systems should focus on achieving the objectives of the organization at multiple levels. Internal control is a process that consists of various tasks and overlapped activities. It is a method of achieving a specific objective, rather than an end in itself. Internal control systems should have the “appropriate” amount of flexibility. If the system is too rigid, it may not be cost-effective or efficient. On the other hand, if the system is too flexible, it could lead to increased internal control risks. Therefore, it is crucial to strike the right balance between flexibility and control. The internal control system should be compatible with the organizational structure.