

Short Paper

The Role of Internal Control Guidance in the Modern Economy and Its Impact on Audit Governance in the U.S.

Victor W Gaines DBA¹ & Karina Kasztelnik Ph.D^{2*}

¹ Pacific Union College, Angwin, California, USA

² Grand Canyon University, Phoenix, Arizona, USA

* Karina Kasztelnik Ph.D, Grand Canyon University, Phoenix, Arizona, USA

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Abstract

Whether it is the private sector or public sector, it is important for auditors to have an adequate framework when evaluating internal control systems governance. One of the most widely used frameworks used by audit practitioners is the COSO Internal Control-Integrated Framework Governance. As auditors examine different global frameworks, one can quickly identify the importance the COSO Internal Control-Integrated Framework Governance has on evaluating internal control systems globally. As audit practitioners, it is essential to have a universal framework that can systematically assist in evaluating an internal control system. As auditors and management look toward the future, whether it is private or public sector auditing, they can-will see the fingerprints of the COSO Internal Control-Integrated Framework Governance in evaluating future internal control systems throughout the world. This article are helpful to both the pravite sector management and policymakers.

Keywords

COSO, government auditing, governance, internal control, public sector

1. Introduction

Public sector auditing is essential to the accountability and transparency of directed programs by ensuring their sufficient implementation in the global economy. Elmore (2013) reiterated that as the government watchdogs, public sector auditors play a unique role in promoting the overall trust in the public sector. However, if there is a breakdown in this trust and confidence, the effectiveness of implementing the desired programs to assist in the well-being of the citizens will be drastically decreased. As the public sector becomes increasingly aware of the importance of governance, worldwide governments look toward audit departments to help ensure an adequate internal control system. While a

weak internal control system may have negative ramifications on the organization's overall control environment, Badara and Saidin (2013) suggest that the public sector should improve the effectiveness of their control environment to provide good governance.

As with their corporate counterparts, public sector auditors must have detailed knowledge of the entity they audit. Marsh, Fischer, and Montondon (2013) explained that audit departments must have a clear understanding of the entity and the surrounding economic environment. This clear understanding assist auditor's in their pursuit of helping governments implement their desired program while facing a weakening revenue source. This concept is critical for a well-functioning public sector audit department. Although the audit function is critical to the public sector as it pertains to corporate governance, it is equally important as a monitoring mechanism for the public sector. De Vries (2013) states that good governance is just the government doing the right thing. The author also reiterated that a competent government depends less on politicians and more on the public sector's ability to maintain trust and confidence, along with delivering the needed services. This monitoring activity amplifies the value of public sector auditing.

2. Internal Control Systems Governance

To have an effective integrated control system, one must start with internal control. Broadly defined, internal controls are those methods and procedures embedded into the organization by management to ensure the correct implementation of management's policies and procedures. Internal control is not a means to an end, but a process that is ongoing. Therefore, an organization must continuously review their internal control systems to ensure that the controls are operating effectively and efficiently. Kapić (2013) adds that internal control is a system assist management in ensuing the successful implementation of their organizational objectives. These objectives may include (a) reliability of the financial statements, (b) compliance with laws and regulations, (c) the effectiveness and efficiency of the business operations, and (d) the safeguarding of assets. Because of the increasing importance of an organization's efficiency and effectiveness is to their daily operation, the system of internal controls becomes increasingly important in their ability to meet their objectives.

While the concept of internal controls does focus on methods and procedures, it also contributes to the organization's attitudes and culture. Vijayakumar and Nagaraja (2012) reiterated that in a broad sense, internal controls surround the organization's strategic governance and processes, which interned, leads to their overall performance. This is significant because not only does this defined internal control, but it also identifies how internal controls contribute to the overall good governance of the organization.

Some internal controls can be challenging to evaluate because they interact with different functions throughout the organization. For auditors to assess an organization's internal control system, they must develop ways or methods to ensure that these controls are in place and acting effectively. To do this, a framework must be used to allow auditors to apply a systematic evaluation for the purpose to review the organization's internal control system. The absence of a framework could lead to miss-classification of

control weaknesses within the internal control system. Consequentially, a weakness in the internal control system could result in the misappropriation of assets or ineffectiveness in implementing a service that is designed to benefit the well-being of the citizens.

3. COSO Internal Control-Integrate Framework Governance

With several internal control frameworks governance available, one may ask which of these frameworks would be more suited for the public sector. Whereas in most organizations, their industry may dictate what framework they may use, the most widely used and researched framework is the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in 1992. Formed in 1985, COSO consists of five sponsoring organizations: the American Accounting Association, the AICPA, the Financial Executives International, the Institute of Internal Auditors, and the Institute of Management Accountants. Each of these groups had a wealth of knowledge in the areas of accounting and auditing industry. Together, these organizations were able to develop one of the most comprehensive and widely used integrated frameworks on internal control.

The COSO Internal Control-Integrated Framework Governance provides a universal definition of the concept of internal control. Additionally, this framework provides auditors with a theoretical basis for evaluating an organization's internal control system (Wilson, Wells, Little, & Ross, 2014). This theoretical basis of the COSO Internal Control-Integrated Framework Governance rotates around five components of internal control. These components include (1) control environment, (2) risk assessment, (3) control activities, (4) information and communication, and (5) monitoring activities (Wilson et al., 2014).

Broadly defined, the control environment component focuses on the integrity, ethical values, management philosophy, and operating style of the organization. Risk assessment emphasizes the identification and evaluation of the risk that may jeopardize the organization's ability to reach its goals. Control activities are those policies and procedures within the organization that contribute to the overall control aspect of management. Information and communication focus on the ability of management to communicate between this decision-makers and stakeholders. This may also include the organization stockholders. Finally, monitoring emphasizes the continuous assessment of quality through the use of the internal control system itself (Committee of Sponsoring Organizations of the Treadway Commission, 2013). Each of these components can identify weaknesses throughout the organization's internal control system. This initial framework was intended to assist organizations in managing and developing their particular internal control system, along with, having the ability to adapt to the changing industry (Janvrin, Payne, Byrnes, Schneider, & Curtis, 2012). In 2013, the Committee of Sponsoring Organizations of the Treadway Commission revised the framework to include 17 principles. These principles added clarity regarding the role, implementation, and behavior of internal control (Burns & Simer, 2013; D'Aquila, 2013).

Table 1. Five Internal Control Components with Their Corresponding Principles

Control Environment	Risk Management	Control Activities	Information and Communication	Monitoring Activities
<ul style="list-style-type: none"> • Commitment to integrity and ethical values • Independence and oversight responsibility • Structure, authority, and responsibilities • Commitment toward competence • Accountability 	<ul style="list-style-type: none"> • Specify objectives clearly • Identifies and analyzes risk • Assesses fraud risk • Identifies and utilizes changing to internal control 	<ul style="list-style-type: none"> • Selects and develops control activities • Selects and develops control activities over technology • Implement policies and procedures 	<ul style="list-style-type: none"> • Uses relevant information • Internal communication • External communication 	<ul style="list-style-type: none"> • Conducts ongoing reviews and evaluations • Evaluate and communicate internal control deficiencies

Note. Adapted from “COSO enhances its internal control: Integrated framework governance,” by J. Burns and B. Simer, 2013, *Deloitte-HeADS Up*, 20(17), pp. 1-16.

4. Internal Control Framework for the Public Sector

While the COSO Internal Control-Integrated Framework Governance works well for those organizations in the private sector, one may ask what type of framework would be adequate for those in the public sector. Additionally, is there such a framework that can be used globally for evaluating an internal control system in the public sector? To be able to answer these two questions, one may first look at the *Standards for Internal Control in the Federal Government* better known as “The Green Book”.

The revised 2014 *Standards for Internal Control in the Federal Government* provides the United States government departments criteria for designing and implementing an adequate internal control system. To ensure that The Green Book can meet the challenges faced by the federal government, the GAO turned to COSO Internal Control-Integrated Framework Governance as a primary source in revising The Green Book in 2014. These revised standards apply not only to the US federal government but also sustained in local entities and not-for-profit organizations (U.S. Government Accountability Office, 2014). However, it is up to the managers of these organizations to implement this framework based upon the appropriate laws and regulations.

As with the COSO Internal Control-Integrated Framework Governance, The Green Book includes five components of internal control and 17 principles that support the practical design, implementation, and operation of their associated components. As like COSO Governance, to establish an effective internal

control system, all of these components and principles are required to be implemented in the organization's internal control system (U.S. Government Accountability Office, 2011).

When one compares the COSO Internal Control-Integrated Framework Governance to The Green Book, one will find some strong similarities. Although there may be some minor differences between COSO and The Green Book, these differences only contributed to the attribute section of The Green Book. Their similarities include the five components of internal control along with 17 principles associated with each element. While one may identify the importance of the COSO Internal Control-Integrated Framework Governance as it relate to the US public sector, how does this pertain to the public sector globally?

In 2004, the International Organization of Supreme Audit Institutions (INCOCAI) published a revision to the International Standards of Supreme Audit Institutions (ISSAI) GOV-9100 "*Guidance for Internal Control Standards in the Public Sector*" to promote the design, implementation, and evaluation of internal control. The 17th INCOCAI realized there was a need to update the present guidelines so that they agree with the COSO Internal Control-Integrated Framework Governance. Thus in 2004, the INTOSAI approved the revision of the Guidelines for Internal Control Standards for the Public Sector in Budapest. These guidelines contain the same five components of internal control in several principles associated with each component of COSO (INTOSAI GOV 9100, 1992). While these principles may not be precisely word-for-word from the COSO Internal Control-Integrated Framework Governance, one can quickly identify the origin of each of these principles originated from COSO.

Table 2. Comparison COSO Internal Control-Integrated Framework, the Standards for Internal Control in the Federal Government and the Guidance for Internal Control Standards in the Public Sector INTOSAI GOV-9100

COSO Internal Control-Integrated Framework	<i>Standards for Internal Control in the Federal Government</i>	Guidance for Internal Control Standards in the Public Sector INTOSAI GOV-9100
Control Environment	Control Environment	Control Environment
<ul style="list-style-type: none"> • Commitment to integrity and ethical values • Independence and oversight responsibility • Structure, authority, and responsibility 	<ul style="list-style-type: none"> • Commitment to integrity and ethical values • Independence and oversight responsibility • Structure, authority, and responsibility 	<ul style="list-style-type: none"> • Commitment to integrity and ethical values • Organizational structure • Tone at the top
Risk Management	Risk Management	Risk Management
<ul style="list-style-type: none"> • Specifies objectives clearly • Identifies and analyze risk • Assesses fraud risk 	<ul style="list-style-type: none"> • Specifies objectives clearly • Identifies and analyze risk • Assesses fraud risk 	<ul style="list-style-type: none"> • Risk identification • Risk evaluation • Risk appetite

Control Activities	Control Activities	Control Activities
<ul style="list-style-type: none"> • Selects and develops control activities • Selects and develops control activities over technology 	<ul style="list-style-type: none"> • Selects and develops control activities • Selects and develops control activities over technology 	<ul style="list-style-type: none"> • Authorizations and approval procedures • Segregation of duties and control over access resources and records

5. Conclusion

As we examine each of these frameworks, one can quickly identify how the COSO Internal Control-Integrated Framework not only influences internal auditing in the private sector but also influences guidance in the global economy. As an auditing practitioner or manager, the importance of a universal governance framework is self-evident. Whether it is the public sector in the United States or the rest of the world, there is a need for consistency when evaluating an internal control system. The COSO Internal Control-Integrated Framework Governance serves as a benchmark to assess internal control systems. As audit practitioners, we need to ensure that the governance guidance we use can effectively identify those issues that may cause the organization not meeting its goals. One way to help to ensure this is to start with the COSO Internal Control-Integrated Framework Governance as a guiding principle when evaluating an internal control system. We may not know what the future brings in public auditing governance, one thing we can say is that the COSO Internal Control-Integrated Framework Governance will play a part in evaluating future internal control systems governance and assist organizations in meeting their global economy goals.

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