

1-1-1992

Internal control, integrated framework: Evaluation tools, Revised draft February 1992

Committee of Sponsoring Organizations of the Treadway Commission

Follow this and additional works at: https://egrove.olemiss.edu/aicpa_assoc



Part of the [Accounting Commons](#), and the [Taxation Commons](#)

Recommended Citation

Committee of Sponsoring Organizations of the Treadway Commission, "Internal control, integrated framework: Evaluation tools, Revised draft February 1992" (1992). *Association Sections, Divisions, Boards, Teams*. 197.
https://egrove.olemiss.edu/aicpa_assoc/197

This Article is brought to you for free and open access by the American Institute of Certified Public Accountants (AICPA) Historical Collection at eGrove. It has been accepted for inclusion in Association Sections, Divisions, Boards, Teams by an authorized administrator of eGrove. For more information, please contact egrove@olemiss.edu.

***INTERNAL CONTROL—
INTEGRATED FRAMEWORK***

EVALUATION TOOLS

*Revised Draft
February 1992*

*Committee of Sponsoring Organizations
of the Treadway Commission*

*INTERNAL CONTROL—
INTEGRATED FRAMEWORK*

EVALUATION TOOLS

*Revised Draft
February 1992*

*Copyright © 1992 by
The Committee of Sponsoring Organizations
of the Treadway Commission
1211 Avenue of the Americas, 6th floor
New York, NY 10036-8775*

**COMMITTEE OF SPONSORING ORGANIZATIONS
OF THE TREADWAY COMMISSION (COSO)**

Issuer of Report

	Representative
American Institute of Certified Public Accountants	Robert L. May, Chairman
American Accounting Association	Alvin A. Arens
The Institute of Internal Auditors	William G. Bishop, III
Institute of Management Accountants	Thomas M. O'Toole
Financial Executives Institute	P. Norman Roy

PROJECT ADVISORY COUNCIL TO COSO

Guidance, Oversight

Gaylen N. Larson, Chairman
*Group Vice-President,
Chief Accounting Officer
Household International*

C. Perry Colwell
*Sr. Vice President -
Financial Management
AT&T (retired)*

John H. Stewart
*Assistant Treasurer
IBM Corporation*

Andrew D. Bailey
*Professor, Department of Accounting
College of Business and
Public Administration
The University of Arizona*

William J. Ihlanfeldt
*Assistant Controller
Shell Oil Company*

Howard L. Siers, Consultant
*General Auditor
E.I. Du Pont de Nemours and
Company, Inc. (retired)*

Roger N. Carolus
*Senior Vice President
NCNB Corporation (retired)*

David L. Landsittel
*Managing Director - Auditing
Arthur Andersen & Co.*

COOPERS & LYBRAND

Author

Principal Contributors

Vincent M. O'Reilly
*Deputy Chairman, Accounting
and Auditing*

R Malcolm Schwartz
*Principal
New York Office*

Richard M. Steinberg
*Partner
National Office*

Frank J. Tanki
*Director, Accounting
and SEC Technical Services*

Robert J. Spear
*Partner
Boston Office*

CONTENTS

	<u>Page</u>
<u>Introduction</u>	1
<u>Blank Tools</u>	3
Control Environment	5
Risk Assessment	19
Control Activities	28
Information and Communication	30
Monitoring	35
Risk Assessment and Control Activities Worksheet	40
Overall Internal Control System Evaluation	41
<u>Reference Manual</u>	43
<u>Sample Filled-in Tools</u>	95
Control Environment	97
Risk Assessment	111
Control Activities	125
Information and Communication	127
Monitoring	133
Risk Assessment and Control Activities Worksheet	139
Overall Internal Control System Evaluation	150

INTRODUCTION

This volume contains a set of tools that may be useful in conducting an evaluation of an entity's internal control system. The tools may be used in any of several ways:

- o Individually, when evaluating a particular component, or together when evaluating all components.
- o In evaluating controls related to one category of controls, such as financial information, or more than one category.
- o When focusing on certain activities, such as procurement or sales, or all activities.

The evaluation tools are presented as follows:

- o A set of blank tools, organized by component, along with one to assist in assembling the results in making an overall evaluation.
- o A reference manual designed to assist the evaluator in completing the "Risk Assessment and Control Activities Worksheet." Also presented is a generic business model which serves as the organizational basis for the reference manual.
- o Filled-in tools, depicting how they might be completed for a hypothetical company.

These evaluation tools are intended to provide guidance and assistance in evaluating internal control systems in relation to criteria for effective internal control set forth in the Framework volume of this report. Accordingly, users of these materials should be familiar with that volume.

These tools are presented for purely illustrative purposes. They are not an integral part of the Framework, and their presentation here in no way suggests that all matters addressed in them need to be considered in evaluating an internal control system, or that all such matters must be present in order to conclude that a system is effective. Similarly, there is no suggestion that these tools are a preferred method to conduct and document an evaluation. Because facts and circumstances vary between entities and industries, evaluation methodologies and documentation techniques will also vary. Accordingly, entities may use different evaluation tools, or use other methodologies utilizing different evaluative techniques. For those entities that do plan to use these tools in some way, it is suggested that they be used only as a starting point, and be modified to reflect the particular facts, conditions and risks relevant to their own circumstances.

These evaluation tools can be used by entities of any size. When used by small or mid-size entities, the tailoring process should recognize that smaller entities tend to be less

formal and less structured than large organizations, that fewer organization levels will likely result in the CEO and other key managers communicating more directly and continuously with lower level personnel, and that these factors will affect the way control is exercised. The sample filled-in tools contained in this volume have been completed using a hypothetical mid-size company and may provide guidance to companies of such size in completing the tools.

BLANK TOOLS

Component Tools

Five evaluation tools are presented, one for each internal control component. A heading and brief introduction identifies each factor or significant element within a component.

Substantive issues to be addressed are contained under the column heading "points of focus." The points of focus are identified by the symbol ■, and represent some of the more important issues relevant to the component. Not all points of focus are relevant to every entity, and additional issues will be relevant to some entities. It is suggested that the evaluator tailor the points of focus to fit the entity's facts and circumstances by adding, deleting or modifying those provided in the tool.

Included under each point of focus are examples of subsidiary issues that might be considered in addressing the point of focus. It is important to recognize that only a few examples of such subsidiary issues are provided. Many others usually are relevant. The examples provided are intended only to illustrate the types of items to consider.

The evaluator addresses each point of focus, considering the example subsidiary issues as well as others not presented. Although one could record a response for each example subsidiary issue, it is suggested that a response be provided only to the point of focus. The "description/comments" column provides space to record a description of how matters addressed in the point of focus are applied in the entity, and to record relevant comments. The response generally will not be a "yes" or "no" answer, but rather information on how the entity addresses the matter.

At the end of each section is a space to record a conclusion on the effectiveness of the related controls, and any actions that might need to be taken or considered. Space is provided at the end of each tool for similar information on the entire component.

Risk Assessment and Control Activities Worksheet

As noted in the evaluation tools for Risk Assessment and Control Activities, management establishes objectives for each significant activity; analyzes risks to their achievement; establishes plans, programs and other actions to address the risks; and puts in place control activities to assure that the actions are carried out. The tools for Risk Assessment and Control Activities do not provide a vehicle to evaluate this process at the activity level. A separate worksheet is provided to assist in this regard.

Management may or may not have already documented this process. If not, the worksheet (page 40) provides a vehicle to assist management in performing and documenting the process. An evaluator then can review the completed worksheet. If management has no documentation, the evaluator might consider preparing the

worksheet (with the assistance of management) in order to evaluate the process and associated linkages.

The reference manual (beginning on page 43) is designed to assist in identifying activity level objectives, analyzing the risks, and determining what actions might be taken and what control activities put in place.

Overall Internal Control System Evaluation

An evaluation tool is provided to serve as a summary of the findings and conclusions for each of the components, and to facilitate review of the preliminary results by more senior executives and their addition of further information. Space for an overall conclusion on the internal control system is provided.

CONTROL ENVIRONMENT

Points of Focus

Description/Comments

Integrity and Ethical Values

Management must convey the message that integrity and ethical values cannot be compromised, and employees must receive and understand that message. Management must continually demonstrate, through words and actions, a commitment to high ethical standards.

- **Existence and implementation of codes of conduct and other policies regarding acceptable business practice, conflicts of interest, or expected standards of ethical and moral behavior.** For example, consider whether:
 - Codes are comprehensive, addressing conflicts of interest, illegal or other improper payments, anti-competitive guidelines, insider trading.
 - Codes are periodically acknowledged by all employees.
 - Employees understand what behavior is acceptable or unacceptable, and know what to do if they encounter improper behavior.
 - If a written code of conduct does not exist, the management culture emphasizes the importance of integrity and ethical behavior. This may be communicated orally in staff meetings, in one-on-one interface, or by example when dealing with day-to-day activities.

- **Establishment of the "tone at the top" – including explicit moral guidance about what is right and wrong – and extent of its communication throughout the organization.** For example, consider whether:
 - Commitment to integrity and ethics is communicated effectively throughout the enterprise, both in words and deeds.
 - Employees feel peer pressure to do the right thing, or cut corners to make a "quick buck."
 - Management appropriately deals with signs that problems exist, e.g., potential defective products or hazardous wastes, especially when the cost of identifying problems and dealing with the issues could be large.

- Dealings with employees, suppliers, customers, investors, creditors, insurers, competitors, and auditors, etc. (e.g., whether management conducts business on a high ethical plane, and insists that others do so, or pays little attention to ethical issues). For example, consider whether:
 - Everyday dealings with customers, suppliers, employees and other parties are based on honesty and fairness (e.g. customer's overpayment or a supplier's underbilling are not ignored, no efforts are made to find a way to reject an employee's legitimate claim for benefits, and reports to lenders are complete, accurate and not misleading).

- Appropriateness of remedial action taken in response to departures from approved policies and procedures or violations of the code of conduct. Extent to which remedial action is communicated or otherwise becomes known throughout the entity. For example, consider whether:
 - Management responds to violations of behavioral standards.
 - Disciplinary actions taken as a result of violations are widely communicated in the entity. Employees believe that, if caught violating behavioral standards, they'll suffer the consequences.

- Management's attitude towards intervention or overriding established controls. For example, consider whether:
 - Management has provided guidance on the situations and frequency with which intervention may be needed.
 - Management intervention is documented and explained appropriately.
 - Manager override is explicitly prohibited.
 - Deviations from established policies are investigated and documented.

- Pressure to meet unrealistic performance targets – particularly for short-term results – and extent to which compensation is based on achieving those performance targets. For example, consider whether:
 - Conditions such as extreme incentives or temptations exist that can unnecessarily and unfairly test people's adherence to ethical values.
 - Compensation and promotions are based solely on achievement of short-term performance targets.
 - Controls are in place to reduce temptations that might otherwise exist.

Points of Focus

Description/Comments

CONCLUSIONS/ACTIONS NEEDED

Competence

Management must specify the level of competence needed for particular jobs, and translate the desired levels of competence into requisite knowledge and skills.

- **Formal or informal job descriptions or other means of defining tasks that comprise particular jobs.** For example, consider whether:
 - Management has analyzed, on a formal or informal basis, the tasks comprising particular jobs, considering such factors as the extent to which individuals must exercise judgment and the extent of related supervision.

Points of Focus

Description/Comments

- **Analyses of the knowledge and skills needed to perform jobs adequately.**
For example, consider whether:
 - Management has determined to an adequate extent the knowledge and skills needed to perform particular jobs.
 - Evidence exists indicating that employees appear to have the requisite knowledge and skills.
-

CONCLUSIONS/ACTIONS NEEDED

Board of Directors or Audit Committee

An active and effective board, or committees thereof, provides an important oversight function and, because of management's ability to override system controls, the board plays an important role in ensuring effective internal control.

- **Independence from management, such that necessary, even if difficult and probing, questions are raised.** For example, consider whether:
 - The board constructively challenges management's planned decisions, e.g., strategic initiatives and major transactions, and probes for explanations of past results (e.g., budget variances).
 - A board that consists solely of an entity's officers and employees (e.g., a small corporation) questions and scrutinizes activities, presents alternative views and takes appropriate action if necessary.

- **Use of board committees where warranted by the need for more in-depth or directed attention to particular matters. For example, consider whether:**
 - Board committees exist.
 - They are sufficient, in subject matter and membership, to deal with important issues adequately.

- **Knowledge and experience of directors. For example, consider whether:**
 - Directors have sufficient knowledge, industry experience and time to serve effectively.

- **Frequency and timeliness with which meetings are held with chief financial and/or accounting officers, internal auditors, and external auditors. For example, consider whether:**
 - The audit committee meets privately with the chief accounting officer and internal and external auditors to discuss the reasonableness of the financial reporting process, system of internal control, significant comments and recommendations, and management's performance.
 - The audit committee reviews the scope of activities of the internal and external auditors annually.

- **Sufficiency and timeliness with which information is provided to board or committee members, to allow monitoring of management's objectives and strategies, the entity's financial position and operating results, and terms of significant agreements. For example, consider whether:**
 - The board regularly receives key information, such as financial statements, major marketing initiatives, significant contracts or negotiations.
 - Directors believe they receive the proper information.

- **Sufficiency and timeliness with which the board or audit committee is apprised of sensitive information, investigations, and improper acts (e.g., travel expenses of senior officers, significant litigation, investigations of regulatory agencies, defalcations, embezzlement or misuse of corporate assets, violations of insider trading rules, political payments, illegal payments).** For example, consider whether:
 - A process exists for informing the board of significant issues.
 - Information is communicated timely.

Points of Focus

Description/Comments

- **Oversight in determining the compensation of executive officers and head of internal audit, and the appointment and termination of those individuals.**
For example, consider whether:
 - The compensation committee approves all management incentive plans tied to performance.
 - The compensation committee, in joint consultation with the audit committee, deals with compensation and retention issues regarding the chief internal auditor.

- **Role in establishing the appropriate "tone at the top."** For example, consider whether:
 - The board and audit committee are involved sufficiently in evaluating the effectiveness of the "tone at the top."
 - The board takes steps to ensure an appropriate "tone."
 - The board specifically addresses management's adherence to the code of conduct.

- **Actions the board or committee takes as a result of its findings, including special investigations as needed.** For example, consider whether:
 - The board has issued directives to management detailing specific actions to be taken.
 - The board oversees and follows up as needed.

CONCLUSIONS/ACTIONS NEEDED

Management's Philosophy and Operating Style

The philosophy and operating style of management normally have a pervasive effect on an entity. These are, of course, intangibles, but one can look for positive or negative signs.

- **Nature of business risks accepted, e.g., whether management often enters into particularly high-risk ventures, or is extremely conservative in accepting risks. For example, consider whether:**
 - Management moves carefully, proceeding only after carefully analyzing the risks and potential benefits of a venture.
- **Personnel turnover in key functions, e.g., operating, accounting, data processing, internal audit. For example consider whether:**
 - There has been excessive turnover of management or supervisory personnel.
 - Key personnel have quit unexpectedly or on short notice.
 - There is a pattern to turnover (e.g., inability to retain key financial or internal audit executives) that may be an indicator of the emphasis that management places on control.
- **Management's attitude toward the data processing and accounting and functions, and concerns about the reliability of financial reporting and safeguarding of assets. For example, consider whether:**
 - The accounting function is viewed as a necessary group of "bean counters," or as a vehicle for exercising control over the entity's various activities.
 - The selection of accounting principles used in financial statements always result in the highest reported income.
 - If the accounting function is decentralized, operating management "sign off" on reported results.
 - Unit accounting personnel also have responsibility to central financial officers.
 - Valuable assets, including intellectual assets and information, are protected from unauthorized access or use.

Points of Focus

Description/Comments

- **Frequency of interaction between senior management and operating management, particularly geographically removed division or subsidiary management. For example, consider whether:**
 - . Senior managers frequently visit subsidiary or divisional operations.
 - . Group or divisional management meetings are held frequently.

- **Attitudes and actions toward financial reporting, including disputes over application of accounting treatments (e.g., selection of conservative versus liberal accounting policies; whether accounting principles have been misapplied, important financial information not disclosed, or records manipulated or falsified). For example, consider whether:**
 - . Management avoids obsessive focus on short-term reported results.
 - . Personnel do not submit inappropriate reports to meet targets (e.g., salespeople submitting orders to meet targets, knowing customers will return goods in the next period).
 - . Managers do not ignore signs of inappropriate practices.
 - . Estimates do not stretch facts to the edge of reasonableness and beyond.

CONCLUSIONS/ACTIONS NEEDED

Organizational Structure

The organizational structure shouldn't be so simple that it cannot adequately monitor the enterprise's activities nor so complex that it inhibits the necessary flow of information. Executives should fully understand their control responsibilities and possess the requisite experience and levels of knowledge commensurate with their positions.

- **Appropriateness of the entity's organizational structure, and its ability to provide the necessary information flow to manage its activities.** For example, consider whether:
 - . The organizational structure is appropriately centralized or decentralized, given the nature of the entity's operations.
 - . The structure facilitates the flow of information upstream, downstream and across all business activities.

- **Adequacy of definition of key managers' responsibilities, and their understanding of these responsibilities.** For example, consider whether:
 - . Responsibilities and expectations for the entity's business activities are communicated clearly to the executives in charge of those activities.

- **Adequacy of knowledge and experience of key managers in light of responsibilities.** For example, consider whether:
 - . The executives in charge have the required knowledge, experience and training to perform their duties.

- **Appropriateness of reporting relationships.** For example, consider whether:
 - . Established reporting relationships -- formal or informal, direct or matrix -- are effective, and they provide managers information appropriate to their responsibilities and authority.
 - . The executives of the business activities have access to communication channels to senior operating executives.

Points of Focus

Description/Comments

- **Extent to which modifications to the organizational structure are made in light of changed conditions.** For example, consider whether:
 - Management periodically evaluates the entity's organizational structure in light of changes in the business or industry.

 - **Sufficient numbers of employees exist, particularly in management and supervisory capacities.** For example, consider whether:
 - Managers and supervisors have sufficient time to carry out their responsibilities effectively.
 - Managers and supervisors work excessive overtime, and are fulfilling the responsibilities of more than one employee.
-

CONCLUSIONS/ACTIONS NEEDED

Assignment of Authority and Responsibility

The assignment of responsibility, delegation of authority and establishment of related policies provide a basis for accountability and control, and set forth individuals' respective roles.

Points of Focus

Description/Comments

- **Assignment of responsibility and delegation of authority to deal with organizational goals and objectives, operating functions and regulatory requirements, including responsibility for information systems and authorizations for changes. For example, consider whether:**
 - . Authority and responsibility are assigned to employees throughout the entity.
 - . Responsibility for decisions are related to assignment of authority and responsibility.
 - . Proper information is considered in determining the level of authority and scope of responsibility assigned to an individual.
- **Appropriateness of control-related standards and procedures, including employee job descriptions. For example, consider whether:**
 - . Job descriptions, for at least management and supervisory personnel, exist.
 - . They contain specific references to control-related responsibilities.
- **Appropriate numbers of people, particularly with respect to data processing and accounting functions, with the requisite skill levels relative to the size of the entity and nature and complexity of activities and systems. For example, consider whether:**
 - . The entity has an adequate workforce -- in numbers and experience -- to carry out its mission.
- **Appropriateness of delegated authority in relation to assigned responsibilities. For example, consider whether:**
 - . There is an appropriate balance between authority needed to "get the job done" and the involvement of senior personnel where needed.
 - . Employees at the "right" level are empowered to correct problems or implement improvements, and empowerment is accompanied by appropriate levels of competence and clear boundaries of authority.

CONCLUSIONS/ACTIONS NEEDED

Human Resource Policies and Practices

Human resource policies are central to recruiting and retaining competent people to enable the entity's plans to be carried out so its goals can be achieved.

- **Extent to which policies and procedures for hiring, training, promoting, and compensating employees are in place.** For example, consider whether:
 - Existing personnel policies and procedures result in recruiting or developing competent and trustworthy people necessary to support an effective internal control system.
 - The level of attention given to recruiting and training the right people is appropriate.
 - When formal documentation of policies and practices does not exist, management communicates expectations about the type of people to be hired or participates directly in the hiring process.

Points of Focus

Description/Comments

- **Extent to which people are made aware of their responsibilities and expectations of them.** For example, consider whether:
 - New employees are made aware of their responsibilities and management's expectations of them.
 - Supervisory personnel meet periodically with employees to review job performance and suggestions for improvement.

- **Appropriateness of remedial action taken in response to departures from approved policies and procedures.** For example, consider whether:
 - Management's response to failures to carry out assigned responsibilities is appropriate.
 - Appropriate corrective action is taken as a result of non-adherence to established policies.
 - Employees understand that ineffective performance will result in remedial consequences.

- **Extent to which personnel policies address adherence to appropriate ethical and moral standards.** For example, consider whether:
 - Integrity and ethical values is a criterion in performance appraisals.

- **Adequacy of employee candidate background checks, particularly with regard to prior actions or activities considered to be unacceptable by the entity.** For example, consider whether:
 - Candidates with frequent job changes or gaps in employment history are subjected to particularly close scrutiny.
 - Hiring policies require investigation for a criminal record.

- **Adequacy of employee retention and promotion criteria and information gathering techniques (e.g., performance evaluations), and relation to the code of conduct or other behavioral guidelines.** For example, consider whether:
 - Promotion and salary increase criteria are detailed clearly so that individuals know what management expects prior to promotions or advancement.
 - Criteria reflect adherence to behavioral standards.

CONCLUSIONS/ACTIONS NEEDED

COMPONENT SUMMARY - CONCLUSIONS/ACTIONS NEEDED

RISK ASSESSMENT

Points of Focus

Description/Comments

Entity-wide Objectives

For an entity to have effective control, it must have established objectives. Entity-wide objectives include broad statements of what an entity desires to achieve, and are supported by related strategic plans. Describe the entity-wide objectives and key strategies that have been established.

- **Extent to which the entity-wide objectives provide sufficiently broad statements and guidance regarding what the entity desires to achieve, which are specific enough to relate directly to this entity.** For example, consider whether:
 - Management has established entity-wide objectives.
 - The entity-wide objectives are different than generic objectives that could apply to any entity (e.g., generate sufficient cash flow to service debt, or produce a reasonable return on investment).

- **Effectiveness with which the entity-wide objectives are communicated to employees and board of directors.** For example, consider whether:
 - Information on the entity-wide objectives is disseminated to employees and the board of directors.
 - Management obtains feedback from key managers, other employees and the board signifying that communication to employees is effective.

- **Relation and consistency of strategies with entity-wide objectives.** For example, consider whether:
 - The strategic plan supports the entity-wide objectives.
 - It addresses high level resource allocations and priorities.

- **Consistency of business plans and budgets with entity-wide objectives, strategic plans and current conditions.** For example, consider whether:
 - Assumptions inherent in the plans and budgets reflect the entity's historical experience and current conditions.
 - Plans and budgets are at an appropriate level of detail for each management level.

CONCLUSIONS/ACTIONS NEEDED

Activity-level Objectives

Activity-level objectives flow from and are linked with the entity-wide objectives and strategies. Activity-level objectives are frequently stated as goals with specific targets and deadlines. Objectives should be established for each significant activity, and those activity-level objectives should be consistent with each other.

- **Linkage of activity-level objectives with entity-wide objectives and strategic plans.** For example, consider whether:
 - . Adequate linkage exists for all significant activities.
 - . Activity-level objectives are reviewed from time to time for continued relevance.
- **Consistency of activity-level objectives with each other.** For example, consider whether:
 - . They are complementary and reinforcing within activities.
 - . They are complementary and reinforcing between activities.

- **Relevance of activity-level objectives to all significant business processes.**
For example, consider whether:
 - . Objectives are established for key activities in the flows of goods and services and support activities.
 - . Activity-level objectives are consistent with past practices and performances or with industry or functional analogues, or the reasons for variance has been considered.
 - . Objectives are established for each significant activity. These activities may include, among others (the activities listed derive from a generic business model, pages 46 to 49; illustrative objectives for each of these activities are presented in a reference manual, pages 51 to 94)
 - Inbound
 - Operations
 - Outbound
 - Marketing and Sales
 - Service
 - Procurement
 - Technology Development
 - Human Resources
 - Manage the Enterprise
 - Manage External Relations
 - Provide Administrative Services
 - information Technology
 - Manage Risk (of accident or other insurable loss)
 - Manage Legal Affairs
 - Plan
 - Process Accounts Payable
 - Process Accounts Receivable
 - Process Funds
 - Process Fixed Assets
 - Analyze and Reconcile
 - Process Benefits and Retiree Information
 - Process Payroll
 - Process Tax Compliance
 - Process Production Costs
 - Provide Financial and Management Reporting
- **Specificity of activity-level objectives.** For example, consider whether:
 - . Objectives include measurement criteria.
- **Adequacy of resources relative to objectives.** For example, consider whether:
 - . Management has identified the resources needed to achieve the objectives.
 - . Plans exist for acquiring necessary resources (e.g., financing, personnel, facilities, technology).

- **Identification of objectives that are important (critical success factors) to achievement of entity-wide objectives. For example, consider whether:**
 - Management has identified what must go right, or where failure must be avoided, for entity-wide objectives to be achieved.
 - Capital spending and expense budgets are based on management's analysis of the relative importance of objectives.
 - The objectives serving as critical success factors provide a basis for particular management focus.

- **Involvement of all levels of management in objective-setting and extent to which they are committed to the objectives. For example, consider whether:**
 - Managers participate in establishing activity objectives for which they are responsible.
 - Procedures exist to resolve disagreements.
 - Managers support the objectives, and do not have "hidden agendas."

CONCLUSIONS/ACTIONS NEEDED

Risks

An entity's risk-assessment process should identify and consider the implications of relevant risks, at both the entity level and the activity level. The risk-assessment process should consider external and internal factors that could impact achievement of the objectives, should analyze the risks, and provide a basis for managing them.

- **Adequacy of mechanisms to identify risks arising from external sources.**
For example, consider whether management considers risks related to:
 - Supply sources
 - Technology changes
 - Creditor's demands
 - Competitor's actions
 - Economic conditions
 - Political conditions
 - Regulation
 - Natural events

- **Adequacy of mechanisms to identify risks arising from internal sources.**
For example, consider whether management considers risks related to:
 - Human resources, such as retention of key management personnel or changes in responsibilities that can affect the ability to function effectively.
 - Financing, such as availability of funds for new initiatives or continuation of key programs.
 - Labor relations, such as compensation and benefit programs to keep the entity competitive with others in the industry.
 - Information systems, such as the adequacy of back-up systems in the event of failure of systems that could significantly affect operations.

- **Identification of significant risks for each significant activity-level objective.**
(Consider risks identified with respect to each of the activities identified under "activity-level objectives"; illustrative risks relative to common objectives are presented in the reference manual, pages 51 to 94).

- **Thoroughness and relevance of the risk analysis process, including estimating the significance of risks, assessing the likelihood of their occurring, and determining needed actions.** For example, consider whether:
 - Risks are analyzed through formal processes or informal day-to-day management activities.
 - The identified risks are relevant to the corresponding activity objective.
 - Appropriate levels of management are involved in analyzing the risks.

CONCLUSIONS/ACTIONS NEEDED

Managing Change

Economic, industry and regulatory environments change and entities' activities evolve. Mechanisms are needed to identify and react to changing conditions.

- Existence of mechanisms to anticipate, identify and react to routine events or activities that affect achievement of entity or activity-level objectives (usually implemented by managers responsible for the activities that would be most affected by the changes). For example, consider whether:
 - . Routine changes are addressed as part of the normal risk identification and analysis process, or through separate mechanisms.
 - . Risks and opportunities related to the changes are addressed at sufficiently high levels in the organization so their full implications are identified and appropriate action plans formulated.
 - . All activities within the entity significantly affected by the change are brought into the process.

- **Existence of mechanisms to identify and react to changes that can have a more dramatic and pervasive effect on the entity, and may demand the attention of top management. For example, for each of the following areas of potential change, consider whether:**

Changed operating environment:

- Market research or other programs identify major shifts in customer demographics, preferences or spending patterns.
- The entity is aware of significant shifts in the work force -- externally or internally -- that could affect available skill levels.
- Legal counsel periodically updates management on the implications of new legislation.

New personnel:

- Special action is taken to ensure new personnel understand the entity's culture and perform accordingly.
- consideration is given to key control activities performed by personnel being moved.

New or redesigned information systems:

- Mechanisms exist to assess the effects of new systems.
- Procedures are in place to reconsider the appropriateness of existing control activities when new computer systems are developed and go "live."
- Management knows whether systems development and implementation policies are adhered to despite pressures to "short-cut" the process.
- Attention is given to the effect of new systems on information flows and related controls, and employee training, including focus on employee resistance to change.

Rapid growth:

- Systems capability is upgraded to handle rapidly increasing volumes of information.
- Work force in operations, accounting and data processing is expanded as needed to keep pace with increased volume.
- A process for revising budgets or forecasts exists.
- A process exists for considering interdepartmental implications of revised unit objectives and plans.

New technology:

- Information on technological developments is obtained through reporting services, consultants, seminars or perhaps joint ventures with companies in the forefront of research and development relevant to the entity.
- New technologies, or applications, developed by competitors are monitored.
- Mechanisms exist for taking advantage, and controlling the use, of new technology applications, incorporating them into production processes or information systems.

New lines, products, activities and acquisitions:

- The ability exists to reasonably forecast operating and financial results.
- The adequacy of existing information systems and control activities for the new line, product or activity is assessed.
- Plans are developed for recruiting and training people with the requisite expertise to deal with new products or activities.
- Procedures are in place to track early results, and to modify production and marketing as needed.
- Financial reporting, legal and regulatory requirements are identified and compiled with.
- The effects on other company products, and on profitability, are monitored.
- Overhead allocations are modified to reflect product contribution accurately.

Points of Focus

Description/Comments

Corporate restructuring:

- . Staff reassignments or reductions are analyzed for their potential effect on related operations.
- . Transferred or terminated employees' control responsibilities are reassigned.
- . Impact on morale of remaining employees, after major downsizing considered.
- . Safeguards exist to protect against disgruntled former employees.

Foreign operations:

- . Management keeps abreast of the political, regulatory, business and social culture of areas in which foreign operations exist.
 - . Personnel are made aware of accepted customs and rules.
 - . Alternative procedures exist in case activities of or communication mechanisms with foreign operations are interrupted.
-

CONCLUSIONS/ACTIONS NEEDED

COMPONENT SUMMARY - CONCLUSIONS/ACTIONS NEEDED

CONTROL ACTIVITIES

Points of Focus

Description/Comments

Control activities encompass a wide range of policies and the related implementation procedures that help ensure that management's directives are effected. They help assure that those actions identified as necessary to address risks to achieve the entity's objectives are carried out.

■ **Existence of appropriate policies and procedures necessary with respect to each of the entity's activities.**

All relevant objectives and associated risks for each significant activity should have been identified in conjunction with evaluating Risk Assessment. Reference may be made to the Reference Manual (pages 43 to 94) which presents, for common business activities, illustrative objectives, risks, and "actions/points of focus for control activities." The listings in that latter column may be useful in identifying what actions management has directed to address the risks, and considering the appropriateness of control activities the entity applies to see that the actions are carried out. It should be recognized that points of focus for general controls (or general computer controls) are presented in the Reference Manual under the activity "Information Technology."

- **Identified control activities in place are being applied properly.** For example, consider whether:
- . Controls described in policy manuals are actually applied and are applied the way that they're supposed to be.
 - . Appropriate and timely action is taken on exceptions or information that require follow-up.
 - . Supervisory personnel review the functioning of controls.

COMPONENT SUMMARY - CONCLUSIONS/ACTIONS NEEDED

INFORMATION AND COMMUNICATION

Points of Focus

Description/Comments

Information

Information is identified, captured, processed and reported by information systems. Relevant information includes industry, economic and regulatory information obtained from external sources, as well as internally generated information.

- **Obtaining external and internal information, and providing management with necessary reports on the entity's performance relative to established objectives. For example, consider whether:**
 - Mechanisms are in place to obtain relevant external information -- on market conditions, competitors' programs, legislative or regulatory developments and economic changes.
 - Internally generated information critical to achievement of the entity's objectives, including that relative to critical success factors, is identified and regularly reported.
 - The information that managers need to carry out their responsibilities is reported to them.

- **Providing information to the right people in sufficient detail and on time to enable them to carry out their responsibilities efficiently and effectively. For example, consider whether:**
 - Managers receive analytical information that enables them to identify what action needs to be taken.
 - Information is provided at the right level of detail for different levels of management.
 - Information is summarized appropriately, providing pertinent information while permitting closer inspection of details as needed rather than just a "sea of data."
 - Information is available on a timely basis to allow effective monitoring of events and activities -- internal and external -- and prompt reaction to economic and business factors and control issues.

- **Development or revision of information systems based on a strategic plan for information systems – linked to the entity's overall strategy – and responsive to achieving the entity-wide and activity-level objectives. For example, consider whether:**
 - . A mechanism (e.g., an information technology steering committee) is in place for identifying emerging information needs.
 - . Information needs and priorities are determined by executives with sufficiently broad responsibilities.
 - . A long-range information technology plan has been developed and linked with strategic initiatives.

- **Management's support for the development of necessary information systems is demonstrated by the commitment of appropriate resources – human and financial. For example, consider whether:**
 - . Sufficient resources (managers, analysts, programmers with the requisite technical abilities) are provided as needed to develop new or enhanced information systems.

CONCLUSIONS/ACTIONS NEEDED

Communication

Communication is inherent in information processing. Communication also takes place in a broader sense, dealing with expectations and responsibilities of individuals and groups. Effective communication must occur down, across and up an organization and with parties external to the organization.

- **Effectiveness with which employees' duties and control responsibilities are communicated.** For example, consider whether:
 - Communication vehicles -- formal and informal training sessions, meetings, and on-the-job supervision -- are sufficient in effecting such communication.
 - Employees know the objectives of their own activity and how his or her duties contribute to achieving those objectives.
 - Employees understand how their duties affect, and are affected by, duties of other employees.

- **Establishment of channels of communication for people to report suspected improprieties.** For example, consider whether:
 - There's a way to communicate upstream through someone other than a direct superior, such as an ombudsman or corporate counsel.
 - Anonymity is permitted.
 - Employees actually use the communication channel.
 - Persons who report suspected improprieties are provided feedback, and have immunity from reprisals.

- **Receptivity of management to employee suggestions of ways to enhance productivity, quality, or other similar improvements.** For example, consider whether:
 - Realistic mechanisms are in place for employees to provide recommendations for improvement.
 - Management acknowledges good employee suggestions by providing cash awards or other meaningful recognition.

- **Adequacy of communication across the organization (for example, between procurement and production activities) and the completeness and timeliness of information and its sufficiency to enable people to discharge their responsibilities effectively.** For example, consider whether:
 - Sales people inform engineering, production and marketing of customer needs.
 - Accounts receivable personnel advise the credit approval function of slow payers.
 - Information on competitors' new products or warranties reach engineering, marketing and sales personnel.
- **Openness and effectiveness of channels with customers, suppliers and other external parties for communicating information on changing customer needs.** For example, consider whether:
 - Feedback mechanisms with all pertinent parties exist.
 - Suggestions, complaints and other input are captured and communicated to relevant internal parties.
 - Information is reported upstream as necessary and follow-up action taken.
- **Extent to which outside parties have been made aware of the entity's ethical standards.** For example, consider whether:
 - Important communications to outside parties are delivered by management level commensurate with the nature and importance of the message (e.g., senior executive periodically explains in writing the entity's ethical standards to outside parties).
 - Suppliers, customers, and others know the entity's standards and expectations regarding actions in dealing with the entity.
 - Such standards are reinforced in routine dealings with outside parties.
 - Improprieties by employees of external parties are reported to the appropriate personnel.

Points of Focus

Description/Comments

- **Timely and appropriate follow-up action by management resulting from communications received from customers, vendors, regulators or other external parties. For example, consider whether:**
 - Personnel are receptive to reported problems regarding products, services or other matters, and such reports are investigated and acted upon.
 - Errors in customer billings are corrected, and the source of the error is investigated and corrected.
 - Appropriate personnel -- independent of those involved with the original transactions -- process complaints.
 - Appropriate actions are taken and there is follow-up communication with the original sources.
 - Top management is aware of the nature and volume of complaints.

CONCLUSIONS/ACTIONS NEEDED

COMPONENT SUMMARY - CONCLUSIONS/ACTIONS NEEDED

Ongoing Monitoring

Ongoing monitoring occurs in the ordinary course of operations, and includes regular management and supervisory activities, and other actions personnel take in performing their duties that assess the quality of internal control system performance.

- **Extent to which management personnel, in carrying out their regular activities, obtain evidence as to whether the system of internal control continues to function.** For example, consider whether:
 - Operating management compares production, inventory, sales or other information obtained in the course of their daily activities to systems-generated information.
 - Integration or reconciliation of operating information used to manage operations with data generated by the financial reporting system.
 - Operating personnel are required to "sign off" on the accuracy of their units' financial statements, and are held responsible if errors are discovered.
- **Extent to which communications from external parties corroborate internally generated information, or indicate problems.** For example, consider whether:
 - Customers implicitly corroborate billing data by paying their invoices, or customer complaints about billings – indicating system deficiencies in the processing of sales transactions – are investigated for their underlying causes.
 - Communications from vendors and monthly statements of accounts payable are used as a control monitoring technique.
 - Suppliers' complaints of unfair practices by purchasing agents are fully investigated.
 - Regulators communicate information to the entity regarding compliance or other matters that reflect on the functioning of the internal control system.
 - Controls that should have prevented or detected the problems are reassessed.

- **Periodic comparison of amounts recorded by the accounting system with physical assets.** For example, consider whether:
 - Inventory levels are checked when goods are taken from inventory storage for shipment, and differences between recorded and actual amounts are corrected.
 - Securities held in trust are counted periodically and compared with existing records.
- **Responsiveness to internal and external auditor recommendations on means to strengthen internal controls.** For example, consider whether:
 - Executives with proper authority decide which of the auditors' recommendations will be implemented.
 - Desired actions are followed up to verify implementation.
- **Extent to which training seminars, planning sessions and other meetings provide feedback to management on whether controls operate effectively.** For example, consider whether:
 - Relevant issues and questions raised at training seminars are captured.
 - Employee suggestions are communicated upstream and acted on as appropriate.
- **Whether personnel are asked periodically to state whether they understand and comply with the entity's code of conduct and regularly perform critical control activities.** For example, consider whether:
 - Personnel are required periodically to acknowledge compliance with the code of conduct.
 - Signatures are required to evidence performance of critical control functions, such as reconciling specified amounts.
- **Effectiveness of internal audit activities.** For example, consider whether:
 - There are appropriate levels of competent and experienced staff.
 - Their position within the organization is appropriate.
 - They have access to the board of directors or audit committee.
 - Their scope responsibilities and audit plans are appropriate to the organization's needs.

CONCLUSIONS/ACTIONS NEEDED**Separate Evaluations**

It is useful to take a fresh look at the internal control system from time to time, focusing directly on system effectiveness. The scope and frequency of separate evaluations will depend primarily on an assessment of risks, and ongoing monitoring procedures.

- **Scope of and frequency with which separate evaluations of the internal control system are performed.** For example, consider whether:
 - Appropriate portions of the internal control system are evaluated.
 - The evaluations are conducted by personnel with the requisite skills.
 - The scope, depth of coverage and frequency is adequate.
- **Appropriateness of the evaluation process.** For example, consider whether:
 - The evaluator gains a sufficient understanding of the entity activities.
 - An understanding is obtained of how the system is supposed to work and how it actually does work.
 - An analysis is made, using the evaluation results as measured against established criteria.
- **Whether the methodology for evaluating a system is logical and applicable to the system under assessment.** For example, consider whether:
 - Such methodology includes checklists, questionnaires or other tools.
 - The evaluation team is brought together to plan the evaluation process and ensure a coordinated effort.
 - The evaluation process is managed by an executive with requisite authority.

- **Appropriateness of the level of documentation given the activity under assessment.** For example, consider whether:
 - Policy manuals, organization charts, operating instructions and the like are available.
 - Consideration is given to documenting the evaluation process.

CONCLUSIONS/ACTIONS NEEDED

Reporting Deficiencies

Internal control deficiencies should be reported upstream with certain matters reported to top management and the board.

- **Existence of mechanism for capturing and reporting identified internal control deficiencies.** For example, consider whether means exist for obtaining reports on deficiencies:
 - From both internal sources and external sources (e.g., customers, suppliers, auditors, regulators).
 - Resulting from ongoing monitoring or separate evaluations.
- **Appropriateness of reporting protocols.** For example, consider whether:
 - Deficiencies are reported to the person directly responsible for the activity and to a person at least one level higher.
 - Specified types of deficiencies are reported to more senior management and to the board.

Points of Focus

Description/Comments

- **Appropriateness of follow up actions.** For example, consider whether:
 - The transaction or event identified is corrected.
 - The underlying causes of the problem are investigated.
 - There is follow up to ensure the necessary corrective action is taken.
-

CONCLUSIONS/ACTIONS NEEDED

COMPONENT SUMMARY - CONCLUSIONS/ACTIONS NEEDED

RISK ASSESSMENT AND CONTROL ACTIVITIES WORKSHEET

Activity: _____

Objectives	Cate- gory O.F.C	Risk Analysis Risk Factors	Likelihood	Actions/ Control Activities/ Comments	Other Objectives Affected	Evaluation and Conclusion
------------	------------------------	-------------------------------	------------	---	---------------------------------	------------------------------

OVERALL INTERNAL CONTROL SYSTEM EVALUATION

Internal Control Components	Preliminary Conclusions/Actions Needed (see individual evaluation tools)	Additional Considerations
------------------------------------	---	----------------------------------

Control Environment -- Does management adequately convey the message that integrity cannot be compromised? Does a positive control environment exist, whereby there is an attitude of control consciousness throughout the organization, and a positive "tone at the top"? Is the competence of the entity's people commensurate with their responsibilities? Are management's operating style, the way it assigns authority and responsibility and organizes and develops its people appropriate? Does the board provide the right level of attention?

Risk Assessment -- Are entity-wide objectives and supporting activity-level objectives established and linked? Are the internal and external risks that influence the success or failure of the achievement of the objectives identified and assessed? Are mechanisms in place to identify changes affecting the entity's ability to achieve its objectives? Are policies and procedures modified as needed?

Control Activities -- Are control activities in place to ensure adherence to established policy and the carrying out of actions to address the related risks? Are there appropriate control activities for each of the entity's activities?

**Preliminary Conclusions/Actions Needed
(see individual evaluation tools)**

Internal Control Components

Additional Considerations

Information and Communication -- Are information systems in place to identify and capture pertinent information -- financial and nonfinancial, relating to external and internal events -- and bring it to personnel in a form that enables them to carry out their responsibilities? Does communication of relevant information take place? Is it clear with respect to expectations and responsibilities of individuals and groups, and reporting of results? And does communication occur down, across and upward in the entity, as well as between the entity and other parties?

Monitoring -- Are appropriate procedures in place to monitor on an ongoing basis, or to periodically evaluate the functioning of the other components of internal control? Are deficiencies reported to the right people? Are policies and procedures modified as needed?

OVERALL CONCLUSION

REFERENCE MANUAL

This reference manual is designed to assist an evaluator in completing the "Risk Assessment and Control Activities Worksheet" (page 40 of the Blank Tools).

The reference manual presents, for common business activities, illustrative objectives, risks and "points of focus for actions/control activities." The listings in this last column may be useful in identifying actions addressing the risks, and related control activities that help ensure the actions are carried out. The manual also identifies where performance indicators may be particularly useful in effecting control. The "category" column indicates the category into which the objectives fall (O - operations, F - financial information, and C - compliance). These categorizations are not precise, and may vary with circumstances.

The manual begins on page 51. It does not purport to list every activity-level objective, risk or point of focus. It may, however, be helpful in identifying relevant items.

Generic Business Model

The activities covered in the reference manual are based on a generic model of a business enterprise (pages 46 to 49). The generic business model depicts major activities, and is organized in levels, from a high level view of an enterprise to increasingly more detailed views.

Exhibit 1, the context level, is the highest level. At this level, the model depicts the interactions of an enterprise with external parties:

- o Vendors and employment candidates provide resources used to bring goods and services to market.
- o A number of other external parties influence the enterprise, including other sources of consumption, public bodies, collaborators, investors and competitors.

Exhibit 2, the activity level, depicts major activities within the enterprise, comprising five basic value chain activities, supported by four infrastructure activities. Each activity receives, performs operations on and transmits goods, services or information. Between vendors and buyers, value chain activities include (page references are to the location in which these activities are addressed in the reference manual):

	<u>Page</u>
o Inbound activities	51 - 53
o Operations	54 - 56
o Outbound activities	57 - 59
o Marketing and sales	60 - 61
o Service	62 - 63

Infrastructure activities -- supporting the value chain activities -- include:

	<u>Page</u>
o Administration (this activity is broken down into its sub-activities in Exhibit 3)	
o Human resources	68 - 70
o Technology	67
o Procurement	64 - 66

Exhibit 3 focuses on the administration activity, depicting its subactivities. These are:

	<u>Page</u>
o Manage Finance (this activity is broken down further into Control, Treasury, Tax & Audit; the Control unit is depicted in further detail in Exhibit 4)	
o Manage the Enterprise	71
o Manage External Relations	72
o Provide Administrative Services	73
o Manage Information Systems	74 - 76
o Manage Risks (of accident or other insurable loss)	77
o Manage Legal Affairs	78
o Plan	79

Exhibit 4 depicts the various administration controllership subactivities:

	<u>Page</u>
o Process Accounts Payable	80 - 81
o Process Accounts Receivable	82
o Process Funds	83 - 85
o Process Fixed Assets	86
o Analyze and Reconcile	87
o Process Benefits and Retiree Information	88
o Process Payroll	89 - 90
o Process Tax Compliance	91
o Process Product Costs	92 - 93
o Provide Financial & Management Reporting	94

The generic business model serves two purposes. As noted, it provides a structure for the reference manual. The activities, transactions and information flows depicted in the model form the basis for the manual.

The generic business model can also be used as a starting point for an evaluator to understand an entity's activities and their relationships to one another and to outside parties, and the information that is generated and used to help control those activities. When used in this way, the generic business model should be tailored to fit the entity being evaluated. It should be modified or augmented with additional information particular

to the entity, such as systems flowcharts, to better understand the entity's activities and information flows. This understanding can, in turn, facilitate an analysis of the risks associated with each activity, and can help to identify points in the system where control should be effected. Those risks, and the entity's related control activities, can be used to help management complete the "Risk Assessment and Control Activities Worksheet."

EXHIBIT 1
Generic Business Model
Context Level

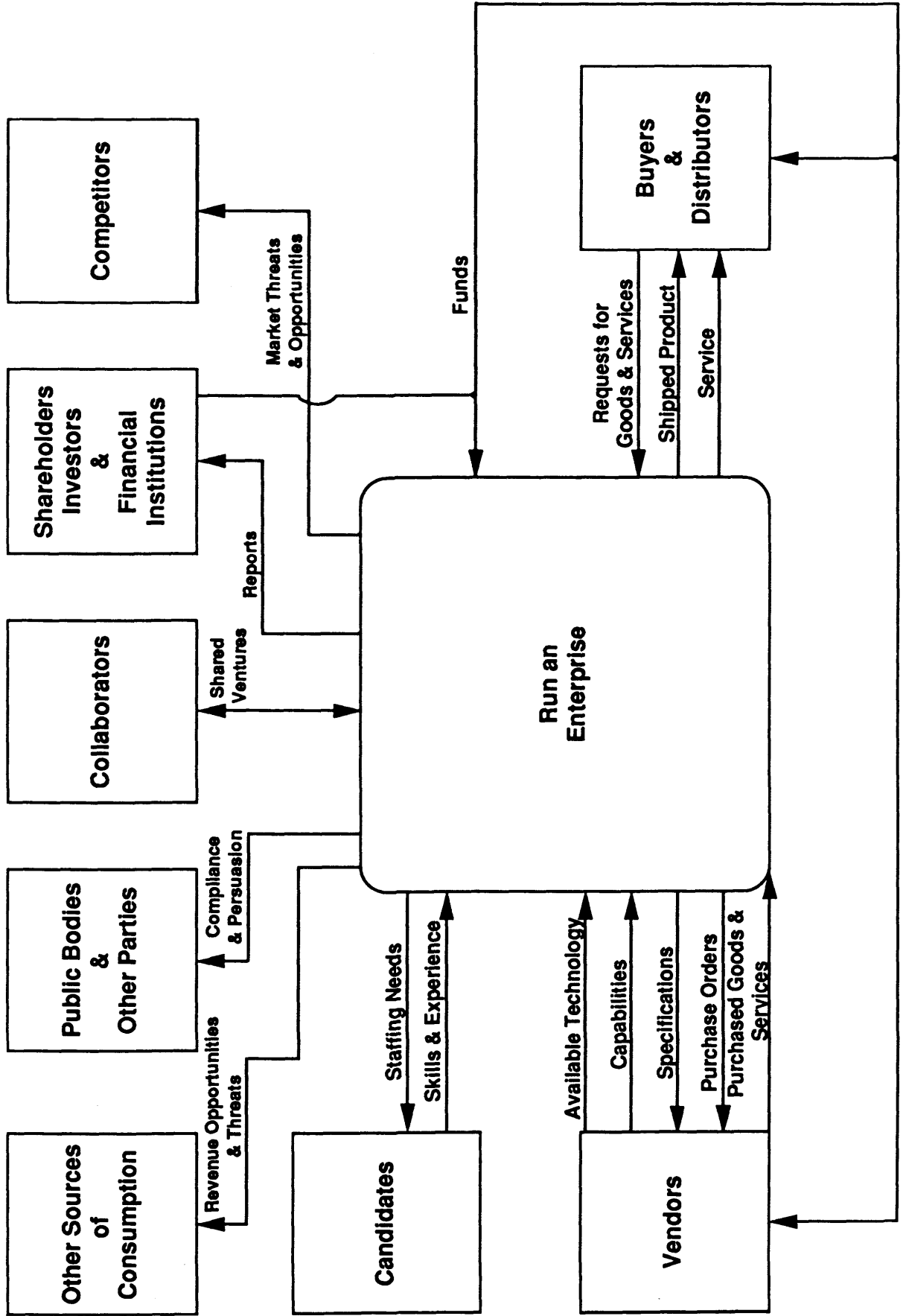
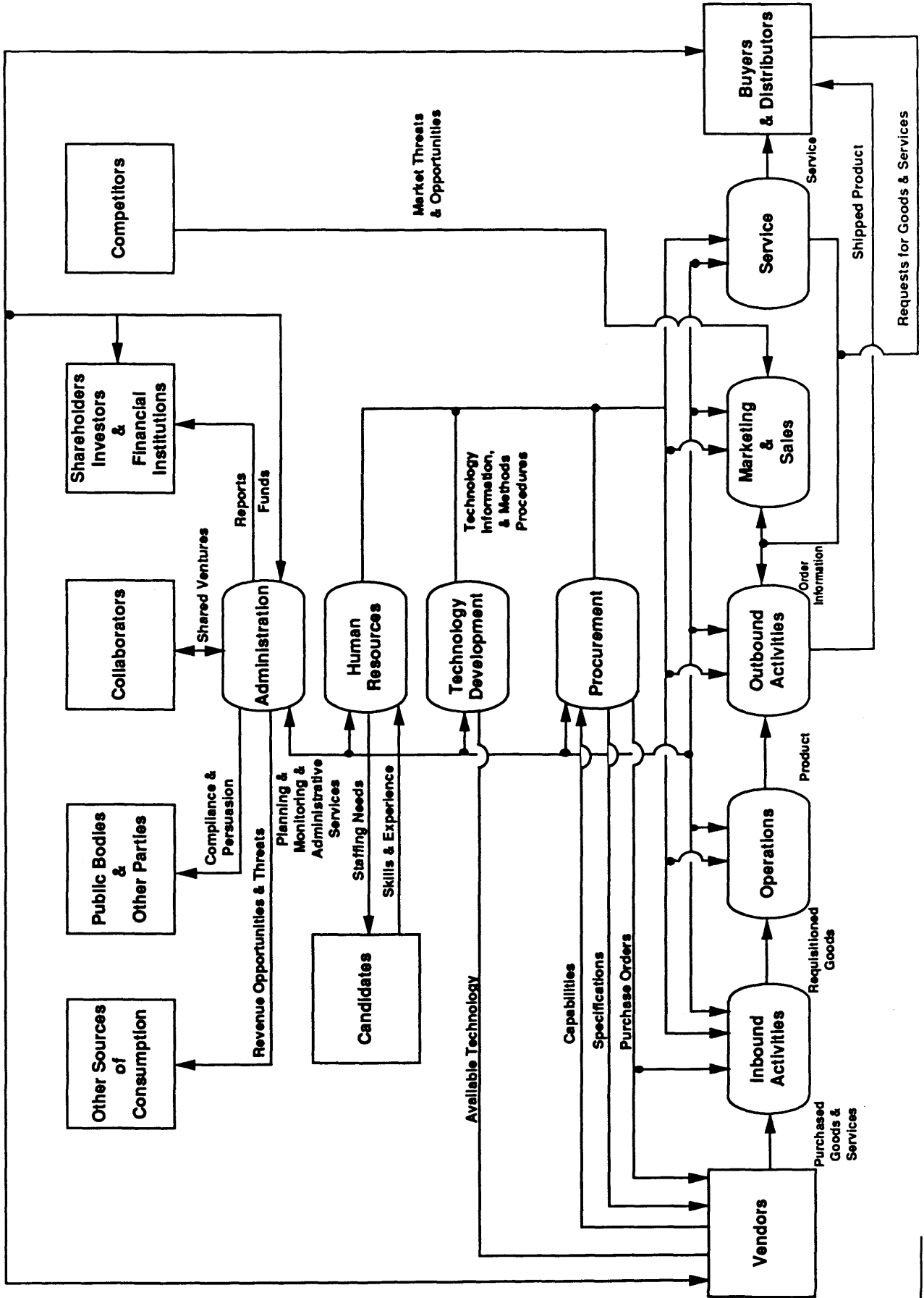
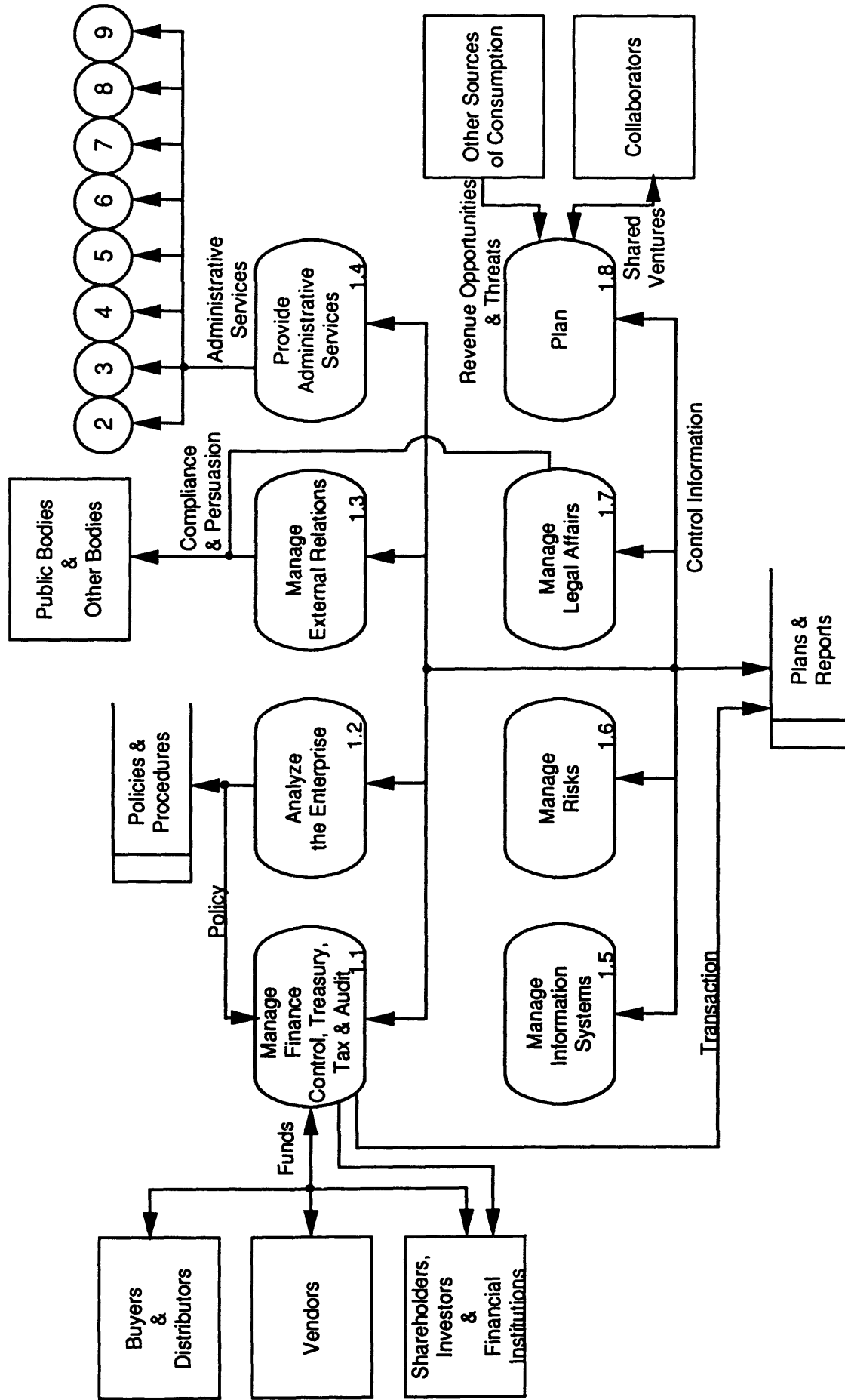


EXHIBIT 2 Generic Business Model Activity Level



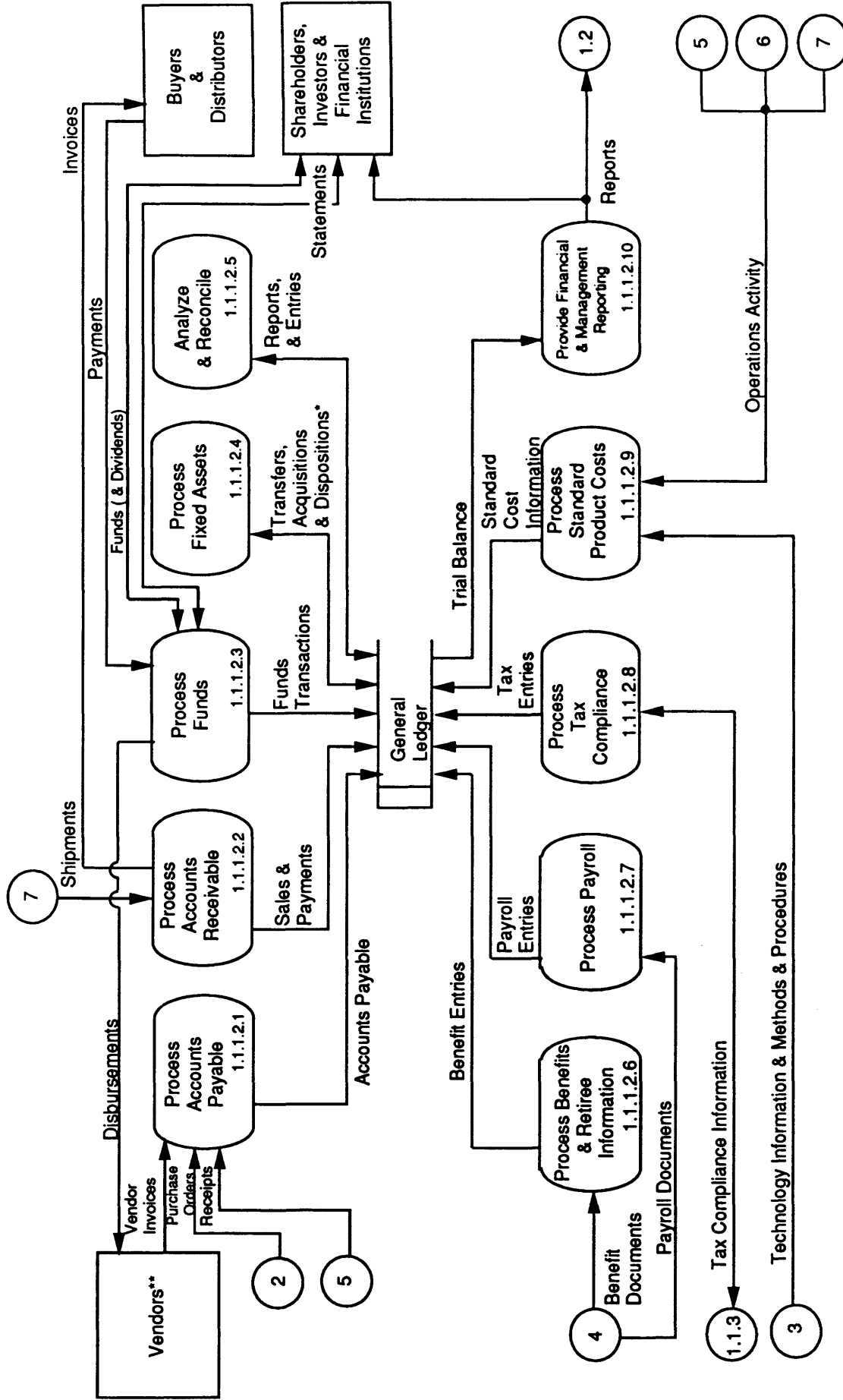
Source: Competitive Advantage, M.E. Porter; and C&L Interpretation

EXHIBIT 3 Generic Business Model Administration Activities



NOTE: Numbers depict other portions of the business model not illustrated.

EXHIBIT 4 Generic Business Model Administration Activities



*Not shown: internal supporting documents.

**Includes payments to employees and retirees, and to tax authorities.

NOTE: Numbers depict other portions of the business model not illustrated.

REFERENCE MANUAL

Activity: Inbound

Objectives	Category <u>O,F,C</u>	Risks	<u>Points of Focus for Actions/Control Activities</u>
<p>Manage Logistics</p>	O,F	<p>Plans and schedules are not communicated to inbound activities, or do not clearly identify when or where materials are needed</p>	<p>Specify on plans and schedules what materials are needed, and when they are needed</p> <p>Communicate all plans and schedules to inbound activities</p> <p>Summarize material requirements and submit them to receiving periodically</p> <p>Maintain material routing procedures for received items</p> <p>Provide inbound activities with nonroutine material routing instructions</p> <p>Monitor production problems related to unavailable materials and parts (performance indicator)</p> <p>Consider implementing Just-in-Time or a similar inventory and production management philosophy</p> <p>Maintain procedures for promptly updating inventory records</p> <p>Match dates on receiving information and inventory information and follow up as appropriate</p> <p>Periodically verify that prenumbered receiving documents have been entered in the information system</p> <p>Purchase orders are prenumbered and missing documents are investigated</p> <p>Maintain open purchase order information in a manner that facilitates identification of purchase orders remaining unfilled past the due date</p> <p>Prenumber documents and investigate missing documents</p>
<p>2. Ensure purchase orders not filled on a timely basis are investigated</p>	O	<p>Information on materials received is not entered into the information system accurately or on a timely basis</p>	<p>Match dates on receiving information and inventory information and follow up as appropriate</p> <p>Periodically verify that prenumbered receiving documents have been entered in the information system</p> <p>Purchase orders are prenumbered and missing documents are investigated</p>
<p>3. Completely and accurately document goods received and goods returned</p>	O,F	<p>Due date information is not available</p> <p>Lost receiving reports or lost shipping records</p>	<p>Maintain open purchase order information in a manner that facilitates identification of purchase orders remaining unfilled past the due date</p> <p>Prenumber documents and investigate missing documents</p>

Activity: Inbound

Objectives	Category O,F,C	Risks	Points of Focus for Actions/Control Activities
Receive			
4. Accept only items that were properly ordered	O	Purchase order information is not made available to inbound activities	Compare materials received, including verification of quantities received, to properly approved purchase orders. Do not accept materials not properly ordered
5. Accept only materials that meet purchase order specifications	O	Purchase order specifications are unclear	Monitor instances of invoices presented for payment when materials were accepted without a valid purchase order (performance indicator) Maintain current lists of specifications to be used in inspecting and testing goods Verify specifications with purchasing or other appropriate personnel Monitor production problems related to substandard materials (performance indicator)
		Materials are not tested for specification compliance	Establish testing procedures, as appropriate, for all materials ordered Monitor production problems related to substandard materials and parts (performance indicator)
6. Ensure that all materials transferred from the receiving activity to other activities are recorded	O,F	Transfer procedures do not require preparation of supporting documentation Transfer documentation may be lost	Require appropriate documentation of materials transferred from receiving to other business activities Prenumber documents and investigate missing documents
7. Safeguard goods received	O	Inadequate physical security over goods received	Periodically count materials on hand and reconcile with perpetual records; investigate any differences (performance indicator) Maintain physical security over goods received
8. Ensure that vendor, inventory, and purchase order information are accurately updated to reflect receipts	O, F	Receiving information may be lost	Segregate custodial and record-keeping functions Prenumber receiving documents and investigate missing documents Periodically identify and investigate open purchase orders Periodically count inventory and reconcile with perpetual inventory records; investigate differences (performance indicator)

Activity: Inbound

Objectives	Category <u>O,F,C</u>	Risks	<u>Points of Focus for Actions/Control Activities</u>
9. Return rejected items promptly	O	Receiving information may be entered inaccurately in the information system, or may not be timely	Periodically verify accuracy of vendor, inventory, and open purchase order information Periodically ensure information is being entered into the information system on a timely basis
10. Completely and accurately document all transfers to and from storage	O,F	Inadequate or untimely inspection of items received Incomplete or inaccurate information regarding materials transferred to/from storage Transfer documents may be lost	Maintain appropriate procedures for inspecting items received Transfer documentation accompanies all transfers; stores or other activities personnel verify materials and quantities received Prenumber transfer documents and investigate missing documents Periodically count materials and reconcile with perpetual records. Investigate differences (performance indicator)
11. Appropriately requisition all goods to be transferred to operations	O,F	Inadequate transfer or requisition procedures	Transfer materials only on the basis of a properly approved requisition
12. Properly transfer all materials requisitioned	O,F,C	Requisitions may be lost Materials not requisitioned are transferred	Prenumber requisitions and investigate missing documents Verify that material received complies with approved requisition
13. Maintain safe working conditions and storage of hazardous materials	C	Inadequate safety considerations	Maintain relevant policies consistent with Occupational Safety and Health Administration (OSHA) and other pertinent laws and regulations, approved by technical and legal personnel, and monitor compliance Following up on reported safety concerns Maintain appropriate procedures for handling and storing hazardous materials

Activity: Operations

<u>Objectives</u>	<u>Category</u> <u>O.F.C.</u>	<u>Risks</u>	<u>Points of Focus for Actions/Control Activities</u>
Manage and Schedule Operations			
1. Schedule operations to minimize inventory and to ensure sufficient availability of completed products in a timely manner.	O	Poor communication with marketing regarding sales forecasts Several products compete for concurrent production	Use standard documents to prepare and communicate sales forecasts Ensure that production personnel receive all sales forecasts Compare production schedules to sales forecasts to ensure scheduled timing and production quantities are appropriate Determine production priorities based on established criteria or management judgment Evaluate adequacy of production capacity Approve all production schedules Use formalized communication channels to inform procurement of material requirements, including quantities and dates materials are required Compare material requirement forecasts with production schedule and product bills of materials; consider effect of lead times required to obtain materials Establish and adhere to accurate and realistic production schedules Consider the costs/benefits of establishing a Just-in-Time system, or similar production and inventory management philosophy Monitor instances of insufficient or excessive raw materials inventory (performance indicator)

Activity: Operations

<u>Objectives</u>	<u>Category O,F,C</u>	<u>Risks</u>	<u>Points of Focus for Actions/Control Activities</u>
2. Minimize production downtime	O	Poorly maintained, misused, or obsolete equipment	<p>Maintain equipment in accordance with an established preventative maintenance program</p> <p>Periodically evaluate production equipment in light of repairs and maintenance cost, capacity, breakdowns, obsolescence and other factors. Consider the costs/benefits of acquiring new equipment</p> <p>Train employees in the proper use of equipment</p> <p>Monitor instances of production downtime due to equipment failure (performance indicator)</p>
Perform Operations		<p>Inadequate skilled labor</p> <p>Natural or other disasters</p>	<p>Train existing employees to perform various tasks</p> <p>Maintain and update contingency and natural disaster plans</p> <p>Periodically test such plans</p>
3. Produce product in appropriate quantities and in accordance with specifications and production schedules	O	<p>Quantities to be produced are not communicated clearly</p> <p>Inappropriate or unclear specifications</p> <p>Excessive work steps/operations</p>	<p>Use standardized documents to prepare and communicate production plans and directives</p> <p>Use standardized documents to communicate product specifications</p> <p>Consider methods to simplify production, such as implementation of Just-in-Time principles</p>
4. Comply with Occupational Safety and Health Administration (OSHA) laws and regulations	O, C	<p>Pressure to meet production deadlines</p> <p>Lack of awareness of laws and regulations</p>	<p>Upper management supports, in statements and actions, safety considerations</p> <p>Enforce disciplinary action on employees who violate safety procedures</p> <p>Monitor safety violations (performance indicator)</p> <p>Conduct periodic training sessions</p> <p>Post laws, regulations, and company policy in conspicuous locations</p>

Activity: Operations

Objectives	Category <u>O.F.C.</u>	Risks	Points of Focus for Actions/Control Activities
Assure Quality	O	Production processes do not include procedures designed to ensure quality production	Integrate quality assurance procedures into production processes Standardize production processes to the extent practicable
5. Product is produced in accordance with quality control standards		Product is difficult to produce Inadequate product testing	Design product with appropriate consideration given to potential production difficulties Test sufficient quantities of each production run to ensure compliance with quality control standards
		Quality problems are not discovered or appropriately reported during the production process	Monitor defect rates (performance indicator) Test products using personnel independent of production processes Monitor customer quality-related returns and complaints (performance indicator)

Activity: Outbound

Objectives	Category <u>O,F,C</u>	Risks	Points of Focus for Actions/Control Activities
Process Orders			
1. Process orders only for customers who are authorized for credit	O	Incomplete, untimely, or inaccurate credit information	Credit authorization systems that provide accurate and timely customer information regarding approved credit limits, current balances due, age of receivable balance, and other pertinent information
2. Process orders accurately and expeditiously	O	Inaccurate or untimely pricing and inventory information Untimely processing of order information	Use current pricing and inventory information Prenumber order forms and periodically follow up on those not processed in a reasonable time frame
3. Process only valid customer orders	O,F	Customer order information may be unclear, inaccurate, or incomplete	Verify customer order information with appropriate marketing/sales personnel; contact customer if necessary
4. Process all approved orders	O	Customer orders may not be authorized Order documentation is lost	Verify appropriate marketing/sales personnel approved customer order Prenumber order forms; investigate missing documents
Store Product			
5. Protect products from damage	O	Employee carelessness Handling and storage procedures, including storage containers, facilities, and maintenance, are inappropriate for the nature of the products	Monitor damage caused by employee carelessness (performance indicator) Store products in containers and facilities designed with consideration for product features and legal and regulatory requirements Create appropriate maintenance procedures and schedules for the nature of the storage facility
6. Store products to facilitate timely order processing	O	Employees are not familiar with handling and storage requirements or procedures Improper organization of storage facility Insufficient storage capacity	Communicate handling and storage policies and procedures clearly to stores employees Monitor compliance with handling and storage policies and procedures (performance indicator) Design and maintain efficient warehouse layout to facilitate order fulfillment Minimize product inventory while enabling timely order fulfillment Identify the appropriate number and location of warehouses
7. Materials are handled and stored in compliance with applicable laws and regulations	C	Employees may not be aware of applicable laws and regulations	Legal counsel, or other qualified personnel, provide information regarding applicable laws and regulations Periodic training regarding legal and regulatory requirements

Activity: Outbound

<u>Objectives</u>	<u>Category</u> O,F,C	<u>Risks</u>	<u>Points of Focus for Actions/Control Activities</u>
8. Maintain complete and accurate records of product stored and available for shipment	O,F	<p>Inappropriate handling and storage policies and procedures</p> <p>Product moved into or out of storage may not be documented or recorded</p> <p>Product may be moved into or out of storage without proper authorization</p>	<p>Review of handling and storage procedures by legal counsel or other qualified personnel</p> <p>Monitor accidents or problems due to inappropriate handling or storage policies or procedures (performance indicator)</p> <p>Product transfer documents are required for movements of product into or out of storage. Such documents are prenumbered, and missing documents are investigated</p> <p>Physical security measures to prevent unauthorized addition to or removal of product from storage</p> <p>Periodically count product in storage and reconcile to perpetual records. Investigate differences between physical count and accounting records</p>
Ship Product			
9. Obtain proper products and quantities from storage	O	<p>Improper products or improper quantities are retrieved from storage</p> <p>Product is unavailable in sufficient quantity</p>	<p>Compare products and quantities retrieved from storage with the customer order and/or product requisition</p> <p>Maintain perpetual product inventory records. Notify operations or other appropriate personnel when inventory drops below a predetermined level</p>
10. Ensure product is packed properly to minimize damage	O	<p>Packing materials, containers or procedures are inappropriate for the nature of the product or method of shipment</p>	<p>Use packing materials, containers or procedures that were designed giving consideration to the nature of the product and method of shipment</p>
11. Ship only those products that are authorized for shipment	O	<p>Incomplete or inaccurate information from order processing</p> <p>Unordered or unauthorized products are included in customer shipment</p>	<p>Compare documents authorizing product shipment with customer order</p> <p>Compare products to customer order prior to shipment</p> <p>Monitor customer returns or billing disputes relating to products delivered but not ordered (performance indicator)</p>
12. Deliver products in the most efficient manner	O	<p>Disruption of normal shipping channels</p> <p>Inaccurate or incomplete shipping documents</p> <p>Use of inefficient shipping methods</p>	<p>Identify alternative shipping arrangements</p> <p>Review shipping documents for completeness and compare to customer order for accuracy before shipment</p> <p>Periodically review shipping alternatives and identify the most efficient alternative</p>

Activity: Outbound

<u>Objectives</u>	<u>Category O.F.C.</u>	<u>Risks</u>	<u>Points of Focus for Actions/Control Activities</u>
13. All shipments are accurately documented, and such documentation is forwarded to accounts receivable on a timely basis	O,F	Incorrect information is entered on shipping documentation Shipping documents are lost	Compare shipping document information with customer order information before shipment Independent verification of shipping document information before shipment Prenumber shipping documents and investigate missing documents
14. Ensure timely shipment of customer order	O	Order or shipping documentation may be lost	Prenumber order and shipping documents; investigate missing documents

Activity: Marketing and Sales

<u>Objectives</u>	<u>Category O,F,C</u>	<u>Risks</u>	<u>Points of Focus for Actions/Control Activities</u>
Manage Marketing Activities			
1. Design marketing strategies giving consideration to competitive, regulatory, business environment or other factors that may influence the entity's marketing activities, and potential changes in those factors	O, C	Inadequate information regarding factors that may influence the entity's marketing strategy	Retain marketing personnel experienced in the entity's industry Promote active membership in industry, trade, or professional associations Monitor legal and regulatory initiatives that may affect the entity Conduct market research, and monitor and analyze economic, customer and industry trends
2. Identify potential and existing customers, and develop marketing strategies to influence those parties to purchase the entity's products or services	O	Inaccurate, untimely, or unavailable information regarding pricing, products, actual or potential customers, advertising, and promotion	Conduct market research Evaluate pricing strategies vis-a-vis competitors' products and pricing Evaluate the effectiveness of advertising and promotion (performance indicator)
3. Maintain delivery capabilities for delivery of products to customers on a timely basis at the least distribution cost	O	Limited number of appropriate distributors Poor performance of distributors	Communication of product capabilities, enhancements, or new products from technology development personnel Identify and evaluate alternative distribution arrangements Communicate appropriate customer information to distributors to ensure timely delivery Monitor distributors' performance in the context of the entity's overall marketing strategy
4. Address market needs for product, including introduction of new products, and continuance, changes to, or discontinuance of existing products	O	Lack of or inaccurate information regarding competitive products or potential new products Products become obsolete	Conduct market research, including existence of competitive products, products under development, and customer preferences Promote active membership in industry, trade, or professional associations Conduct market research, focusing on competitors' technical innovations and customers' acceptance of or preference for such innovations

Activity: Marketing and Sales

Objectives	Category O.P.C.	Risks	Points of Focus for Actions/Control Activities
		Lack of product demand	<p>Monitor the trend of product sales by the entity and the industry</p> <p>Evaluate advertising and promotion effectiveness</p> <p>Conduct market research</p>
		Lack of information regarding profit margins and/or sales prices	<p>Communicate information needs to accounting, management information systems, and other appropriate personnel</p> <p>Monitor profit margins and sales prices for signs of competitive price pressures</p>
Manage Sales Activities			
5. Implement marketing strategies effectively	O	<p>Sales personnel are unaware of marketing strategies</p> <p>Sales personnel disregard marketing strategies</p>	<p>Communicate marketing strategies to sales personnel</p> <p>Establish sales quotas, commissions and other compensation, or other performance criteria in such a manner that failure to implement marketing strategies results in substandard performance evaluations and compensation, and positive implementation of strategies results in increased compensation and recognition</p>
6. Meet or exceed sales targets in an efficient manner	O	<p>Sales personnel are unaware of potential customers</p> <p>Sales people lack knowledge about product features or benefits</p> <p>Incomplete or inaccurate customer information</p>	<p>Communication of market research results from marketing to sales personnel</p> <p>Provide product awareness training</p> <p>Retain qualified and experienced sales staff</p> <p>Maintain customer information system, including name, address, phone number, contact, size, locations, history of previous orders, plans to expand or change the business, or other information that could be useful in marketing the entity's products or services</p> <p>Periodically verify the accuracy of customer information</p>
7. Forward all sales orders to outbound activities and service in a timely manner	O	<p>Sales people perform poorly</p> <p>Sales orders are lost</p>	<p>Retain qualified and experienced sales people</p> <p>Organize salesforce and align territories in most efficient manner</p> <p>Prenumber sales orders and investigate missing documents</p>

Activity: Service	Objectives	Category O.F.C.	Risks	Points of Focus for Actions/Control Activities
	Provide Customer Service			
	1. Handle customer inquiries expeditiously and efficiently	O	Inadequate information systems Untrained staff	Maintain accurate and timely product and customer information Provide staff with initial and periodic product and customer service training Customer service representatives present favorable image to customers and are knowledgeable about products
	2. Satisfy customer service needs so as to further sales and marketing objectives	O	Poor organization of customer service department Lack of awareness of sales and marketing objectives	Organize customer service department in most efficient manner (e.g., along product lines, geographical lines, etc.) Customer service representatives understand the objectives common to marketing, sales and customer service
	Install			
	3. Make authorized installations correctly, efficiently, and on a timely basis	O	Untrained staff Product unavailability	Provide installers with initial and periodic training regarding installation techniques and product features Monitor customer complaints regarding product installation (performance indicator) Coordinate scheduled installations with operations' production schedule and shippings' delivery schedule
			Inaccurate or unavailable customer information	Compare installation authorization documents with customer orders to verify information accuracy and review such documents for completeness
			Unavailability of service personnel	Prenumber installation authorization documents and investigate missing documents Schedule installations and staff utilization to minimize costs
	Provide Warranty Service			
	4. Warranty policies are consistent with marketing and financial strategies	O	Inaccurate market information	Make certain that market information developed by marketing is considered when establishing warranties

Activity: Service

Objectives	Category O.F.C.	Risks	Points of Focus for Actions/Control Activities
5. Investigate and respond to requests for service on a timely basis and in accordance with warranties	O	Insufficient staff	Forecast staffing level requirements Monitor adequacy of staffing, overtime, workloads
Provide Post-Warranty Service		Uncommunicated changes in warranty policies	Communicate changes in product warranty policies to appropriate personnel
6. Customer service representatives use up-to-date pricing and other product information	O	Unavailable or inaccurate information	Update pricing information on order processing systems on a daily basis Provide customer representatives access to order processing systems
7. Investigate and respond to requests for services in the most efficient manner and on a timely basis	O	Insufficient number of customer service representatives or service personnel Improperly trained service personnel	Maintain proper staffing levels and organize the customer service department in the most efficient manner Properly train staff

Activity: Procurement

Objectives	Category O.F.C.	Risks	Points of Focus for Actions/Control Activities
Select Vendor			
1. Identify and purchase from vendors capable of meeting the entity's needs	O	<p>Inadequate vendor screening, including periodic requalification of existing vendors, relating to vendors' abilities to meet:</p> <ul style="list-style-type: none"> . Technical specifications . Quantity requirements . Price . Delivery dates/lead time . Service 	<p>Investigate and periodically update vendor capabilities regarding production quality and capacity, price (including volume or cash discounts and payment terms), order lead-time requirements, current and former customer satisfaction, financial condition, management stability, possible legal restrictions on providing the materials required, and pending litigation</p>
2. Purchase items only from legally qualified vendors and in conformity with applicable laws, regulations, and contracts	O, C	<p>Unavailable or inaccurate information about fraudulent acts or other improper activities of vendors</p>	<p>Periodically update vendor information based on vendor performance in meeting terms and specifications of contracts or purchase orders (e.g., timely delivery of acceptable items, correction of errors or problems, and service)</p> <p>Appropriate review of purchase orders</p> <p>Monitor production problems related to out-of-stock materials and to material specifications (performance indicator)</p> <p>Monitor frequency of returned purchases (performance indicator)</p> <p>Develop data on alternative vendors and periodically reevaluate vendor selection decisions</p> <p>Specify procedures for notification by vendors of potential performance problems and for appropriate investigation and follow-through</p> <p>Maintain updated vendor information</p> <p>Review and approve purchase orders</p> <p>Institute and monitor code of conduct</p> <p>Consider ways to simplify vendor investigation procedures</p>

Activity: Procurement

Objectives	Category <u>O.P.C.</u>	Risks	Points of Focus for Actions/Control Activities
3. Ensure adequate supply of materials	O	<p>Poor communication of operations' or other activities' needs</p> <p>Vendors' inability to provide needed quantities due to other higher-priority orders or an interruption in their own supplies</p>	<p>Timely communication to procurement of operations' or other activities' needs</p> <p>Utilize forward contracts</p> <p>Identify alternate vendors</p> <p>Utilize long-term needs analysis</p>
Purchase			
4. Order items that meet appropriate specifications	O	Inappropriate production specifications	<p>Review existing and revised specifications by technical personnel</p> <p>Monitor and analyze production problems related to material specifications (performance indicator); examples of performance indicators include comparing current-period data on production stoppages and slow-downs, rush orders, spoilage, and material price and quantity variances to prior-period data, peer or industry data, budgets, or other pre-established goals</p>
			Communicate production specifications to procurement personnel
			Appropriate review and approval of contracts and purchase orders
5. Pay appropriate prices	O	Out-of-date or incomplete price information	Obtain competitive bids for each acquisition periodically
			Consider volume purchases by determining total usage of similar materials; combine orders to obtain volume discount
			Appropriate review of purchase orders
			Monitor material price variances (performance indicator)
			Use hedging or forward contracts

Activity: Procurement

Objectives	Category <u>O,F,C</u>	Risks	<u>Points of Focus for Actions/Control Activities</u>
6. Order appropriate quantities at appropriate times	O	Unavailable or inaccurate information on inventory levels or production needs	<p>Maintain accurate perpetual inventory records</p> <p>Match periodic production schedules to inventory information and order lead-time requirements</p> <p>Appropriate review of purchase orders</p> <p>Use forecasts</p> <p>Consider implementing Just-in-Time or a similar inventory and production management philosophy</p>
7. Update vendor information completely and accurately to reflect open purchase orders	O	Information on issued purchase orders is not clearly or completely communicated	Route copies of purchase orders to appropriate personnel
8. Receive items ordered on a timely basis (see also objective no. 2 of Inbound activities)	O	Purchase orders are not entered into the system on a timely basis	Prenumber purchase orders and periodically verify their entry into the system. Investigate unusual time delays in entering data
9. Record authorized purchase orders completely and accurately	O,F	Purchase orders may be lost	Specify shipment mode and delivery date on purchase orders
10. Prevent unauthorized use of purchase orders	O,F	Inadequate policies and procedures to prevent unauthorized use	<p>Prenumber and account for purchase orders</p> <p>Match receiving information with purchase order information and promptly follow through on outstanding orders</p> <p>Monitor vendor performance in terms of timely delivery; follow up in cases of poorly performing vendors</p> <p>Prenumber and account for purchase orders</p> <p>Prenumber and account for purchase orders</p> <p>Maintain physical security of purchase orders</p> <p>Approve purchase orders</p> <p>Notify vendors of company personnel authorized to approve purchase orders</p>

Activity: Technology Development

Objectives	Category <u>O.F.C.</u>	Risks	Points of Focus for Actions/Control Activities
1. Identify existing technology or develop new technology to satisfy product needs as identified by marketing, or operating or management processes needs as identified by other activities	O	Product or processes needs are not effectively communicated to Technology Development Technology Development personnel do not have technical ability to identify or develop appropriate technology Management does not have access to information relating to current technological developments	Clear communication of needs and opportunities to Technology Development Identify needs by appropriate activities Retain personnel who are adequately qualified to fulfill their responsibilities
2. Maintain a high level of knowledge regarding current technological developments that may affect the entity	O, C	Technology Development personnel may acquire or have knowledge that would be useful in a development program other than that with which they are associated Technology may not be adequately defined	Monitor business, technical and industry literature Attend technical seminars, conferences, trade meetings, expositions and similar meetings Periodically summarize technological developments and distribute to appropriate personnel
3. Ensure that developed technology does not violate existing patents	C	Relevant patents may not be identified Existing patents may be disregarded	Regularly communicate information, including nature of the program, status, manager, anticipated use of technology, and any other pertinent information regarding ongoing or planned research or development programs Detailed technology specifications, plans, drawings, schematics, or other technical data are created, to the extent possible, in the concept or early stages of development, and are modified as necessary throughout the project
4. Commit resources to those projects anticipated to have the greatest expected return for the entity	O	Technology development projects do not support entity-wide objectives or strategies Technology development management are unaware of project priorities	Communicate technical data to legal counsel for use when conducting patent searches Appropriate management review and approval of all technology projects Appropriate technology project review and approval Clear and complete communication from management regarding priorities

Activity: Human Resources

Category
O.F.C.

Objectives

Risks

Points of Focus for Actions/Control Activities

Manage Human Resource Programs

1. Comply with applicable laws, regulations, and company policies	C Management or supervisory personnel are unaware of legal and regulatory requirements and company policies Management or supervisory personnel ignore legal and regulatory requirements or company policies	Require supervisory and management personnel to attend training on labor laws and regulations and company personnel policies Periodic review of policies and procedures by legal counsel for compliance with applicable legal and regulatory requirements Encourage personnel to report suspected violations of laws, regulations or company policies
2. Maintain records that demonstrate compliance with applicable laws and regulations	C Human resource personnel are unaware of the records that must be retained to demonstrate compliance with applicable laws and regulations Records are lost or prematurely destroyed	Take appropriate disciplinary actions for violations of legal or regulatory requirements Human resource personnel are subject to periodic training regarding legal and regulatory requirements Human resource personnel have appropriate training and experience prior to being hired File and retain human resource records in accordance with laws, regulations and good business practice
	Inaccurate or incomplete information is acquired and retained	Logs, checklists, or other appropriate tools are used to ensure appropriate records are received and retained
	Record-keeping requirements are disregarded	Access to human resource records is restricted to authorized personnel
		Review and approve all files selected for disposition
		Review validity, accuracy, and completeness of information received and retained in the form of records
		Take appropriate disciplinary or other action when legal or regulatory requirements or company policies are disregarded

Activity: Human Resources

Category
O.F.C.

Objectives

Risks

Points of Focus for Actions/Control Activities

3. Maintain confidentiality of human resource information	O, C	Human resource records are not subject to proper security procedures	<p>Restrict access to human resource records to authorized personnel</p> <p>Require proper security codes to gain access to confidential records maintained on electronic media; change such access codes frequently</p> <p>Monitor personnel accessing human resource records</p>
Human resource personnel divulge confidential information			Subject individuals who provide confidential information to unauthorized persons to disciplinary actions
4. Maintain employee turnover at an acceptable level	O	Compensation and benefits are less than offered by other companies	<p>Restrict access to confidential information to those persons who need such information to discharge their responsibilities</p> <p>Review and evaluate compensation and benefits on a regular basis</p> <p>Compare compensation and benefits with those offered by other companies within the industry and within the local geographical area</p>
Employees may not feel their efforts are noticed or appreciated			Seek employee feedback about their needs
			Periodic, standardized performance evaluations and career counseling
			Institute compensation programs that reflect past performance and capacity for future development
Plan and Acquire Personnel			
5. Acquire sufficient number of appropriately qualified personnel	O	Over- or underqualified candidates may be hired	Maintain appropriate candidate identification, screening and hiring practices
			Maintain adequate job descriptions and hiring criteria that can be used to measure and compare candidates' qualifications with job requirements
Lack of awareness of entity's current human resources			Investigate and review potential candidates inside the entity before considering external candidates
Lack of qualified candidates			Identify and retrain qualified personnel currently performing other job functions
			Establish networks and candidate sources outside of the local geographical area

Activity: Human Resources

Objectives	Category O.F.C.	Risks	Points of Focus for Actions/Control Activities
<p>Train and Develop Employees</p> <p>6. Ensure employees receive adequate training to discharge their responsibilities effectively</p> <p>7. Ensure staff receive adequate feedback regarding their performance and career development</p>	<p>O</p> <p>O</p>	<p>The entity may be unaware of its future staffing needs</p> <p>Labor organizations may call for strikes or work slowdowns</p> <p>Training requirements may not be adequately identified</p> <p>Staff are not evaluated on regular or timely basis</p>	<p>Regularly update future staffing requirements as part of ongoing business planning</p> <p>Continually identify union demands and issues and take reasonable steps to avoid labor disputes</p> <p>Identify viable alternative sources of labor in the event of a labor dispute</p> <p>Solicit opinions and ideas of management, supervisors, and employees to identify training needs</p> <p>Monitor performance or other problems that may indicate training deficiencies</p> <p>Periodically evaluate performance and provide career counseling</p>

Activity: Manage the Enterprise

Objectives	Category <u>O,F,C</u>	Risks	Points of Focus for Actions/Control Activities
1. Design and implement strategies that allow achievement of entity-wide objectives	O	Incomplete or inaccurate information regarding changes affecting the entity, such as competition, products, customer preferences, or legal and regulatory changes	<p>Develop a strategic plan that incorporates senior management's vision for the company</p> <p>Periodically evaluate direction and priorities set by senior management to make certain they are still valid</p> <p>Communicate information regarding competitors, products, customers, and legal and regulatory changes to all relevant activities</p>
2. Maintain systems that allow timely communication of accurate internal and external information to relevant personnel	O,F	<p>Lack of understanding of critical success factors</p> <p>Insufficient or inappropriate resources</p> <p>Inadequate attention to relationships with shareholders, investors, or other outside parties</p> <p>Information is too specific to be usable</p> <p>Out-of-date systems</p>	<p>Establish communication, down, up and across the organization, to allow prompt identification and resolution of problems that impede achievement of strategic objectives</p> <p>Identify and analyze critical success factors from an industry and entity standpoint</p> <p>Identify and maintain adequate supply of internal resources and ensure availability of external resources</p> <p>Effectively communicate with shareholders, investors and other outside parties</p> <p>Establish an executive management reporting system that focuses on key information for managing the business</p> <p>Regularly review information systems to ensure that they meet the changing needs of the company</p>
3. Assure entity personnel are aware of acceptable actions and behavior	O, C	<p>Inaccurate or untimely information</p> <p>Lack of Code of Conduct</p> <p>Employees do not understand the Code of Conduct</p> <p>Employees ignore the Code of Conduct</p> <p>Dishonest employees</p>	<p>Institute information system that ensures the accuracy and timeliness of internal and external information</p> <p>Implement and monitor compliance with Code of Conduct</p> <p>Requirements of the Code of Conduct are reviewed with all new employees, and periodically with all employees</p> <p>Appropriate disciplinary action for violations of the Code of Conduct to clearly communicate the message that violations will not be tolerated</p> <p>Hiring policies and procedures require reference checks on employment candidates</p> <p>Employees found violating laws are subject to appropriate disciplinary action and are reported to the authorities for prosecution</p>

Activity: Manage External Relations

Objectives	Category <u>O.F.C.</u>	Risks	<u>Points of Focus for Actions/Control Activities</u>
1. Attempt to legally influence government policies and regulations that have an impact on the entity's objectives	O	Lack of understanding of government policies	Employ personnel experienced in government affairs as they relate to the entity Monitor and communicate regulatory and other government information Join industry or trade organizations that lobby legislative or regulatory bodies
2. Actively participate in standard-making bodies	O	Participation dependent on appointment Limited number of positions	Establish reputation as industry leader Make certain that entity officials are visible spokespeople on issues that affect the entity
3. Participate in community activities that enhance the public image of the company	O	Lack of information on and awareness of community issues	Encourage staff to support civic endeavors

Activity: Provide Administrative Services

Objectives	Category <u>O.F.C.</u>	Risks	<u>Points of Focus for Actions/Control Activities</u>
1. Provide quality services that are delivered on a timely basis at the least cost	O	<p>Lack of or excess staff</p> <p>Lack of planning procedures that incorporate objectives of administrative services</p> <p>Inadequate accounting systems for allocating costs</p>	<p>Estimate service usage to ensure appropriate staffing levels</p> <p>Where appropriate, evaluate the value of using outside service companies rather than provide service in-house</p> <p>Accurately capture costs and distribute such costs on an equitable basis</p>

Activity: Information Technology

Objectives	Category O,F,C	Risks	Points of Focus for Actions/Control Activities
1. Use information technology (IT) to carry out the entity's strategic plans	O,F,C	Insufficient interaction of information technology, financial, and operating management in developing strategic plans	Develop IT strategic plan that optimizes entity-wide investment in and use of IT, and ensure that IT initiatives support entity's long-range plans Involve users in the development and maintenance of the strategic IT plan Use an IT steering committee
2. Capture, process, and maintain information completely and accurately and provide it to the appropriate people to enable them to carry out their responsibilities	O,F,C	Systems are not designed according to user needs or are not properly implemented	Use a systems development life cycle, which includes the following key aspects or phases: <ul style="list-style-type: none"> - Request for systems design - Feasibility study - General system design - Detailed systems specifications - Program development and testing - System testing - Conversion - System acceptance and approval Use project management procedures to ensure proper management of systems development activities
		System and program modifications are implemented incorrectly	Involve users in review and approval to ensure systems are designed to meet user requirements Use well-controlled system and program change procedures, including: <ul style="list-style-type: none"> - Properly approved system/program change requests - Approved changes are tracked throughout change process - Review and approve final design of changes by users - All changes, including those initiated in data processing, are subject to appropriate testing, and test results are reviewed and approved by user and data processing management - Approve implementation of tested changes by requester - Notify data processing departments affected by changes - Prepare/update documentation (such as operations runbooks, user manuals, program narratives, and system description)
		Computer operations fail to use correct programs, files and procedures	Prepare and adhere to a production job schedule; document and approve departures from the schedule Establish adequate job set-up and execution procedures over: <ul style="list-style-type: none"> - Setting up of batch jobs - Loading on-line application systems - Loading system software

Use control statements and parameters in processing that are in accordance with approved procedures

Require written approval, including user involvement where appropriate, for departures from authorized set-up and execution procedures

Establish adequate procedures for identifying, reporting and approving operator actions, such as:

- Initial loading of system and application software
- System failures
- Restart and recovery
- Emergency situation
- Any other unusual situations

Data files are subjected to unauthorized access

Establish a security policy stating senior management's commitment on information security; demonstrate such commitment through appropriate actions

Establish standards, procedures, and guidelines that translate the security policy into rules and compliance criteria; these standards and procedures normally address such matters as:

- The information classification scheme for information stored on computers and outside of data processing, including security categories (e.g., research, accounting, marketing) and security levels (e.g., top secret, confidential, internal use only, unclassified)
- The data in each information class and the individuals or functions authorized to use the data and the control and protection requirements
- The types of classes of sensitive assets and for each:
 - .. Potential threats
 - .. Protection requirements
- The responsibilities of management, security administration, resource (data, programs or assets) owners, computer operations, system users and internal auditors, with respect to:
 - .. Ownership of resources
 - .. Procedures for granting access
 - .. Procedures for establishing users' and access privileges
 - .. Required authorizations
 - .. Security monitoring
- The consequences of noncompliance with policy, standards, and procedures
- The security implementation plan, if applicable

Activity: Information Technology

Objectives	Category	Risks	Points of Focus for Actions/Control Activities
	O,F,C		
		Programs are subjected to unauthorized modification	Consider the development of an information security risk assessment Use a security or access control software package to enhance the protection of data fields and system and program libraries Use proper system software controls to ensure that system software is properly implemented, maintained and protected from unauthorized changes Maintain proper physical security over computer hardware and software and information stored outside of data processing
3. Information systems are available as needed	O,F,C	Lack of or poor business continuation planning	Establish and maintain a commitment by senior management for business contingencies Develop and maintain a business continuation plan Assess the impact of new or modified systems on business continuation procedures Establish alternative processing arrangements
		Poor back-up and recovery procedures	Regularly back up critical data files, systems, and program libraries and store off-site
		Inadequate safeguarding of IT resources	Regularly test business continuation procedures

Activity: Manage Risks (of accident or other insurable loss)

Objectives	Category O.F.C.	Risks	Points of Focus for Actions/Control Activities
1. Prevent and reduce potential for accidents	O	Certain jobs, activities, or locations are hazardous	<p>Identify hazardous jobs, activities, or locations</p> <p>Implement policies, procedures, or precautions to enhance workers' safety</p> <p>Monitor workers' compensation or related insurance claims and compare with industry averages (performance indicator)</p> <p>Identify causes of accidents and implement appropriate, cost-effective safeguards</p> <p>Ensure that capital expansion plans address safety objectives</p> <p>Provide appropriate safety and training programs to all new employees</p> <p>Provide periodic updates on such programs to existing employees</p>
2. Ensure compliance with applicable Occupational Safety and Health Administration (OSHA) laws and regulations	C	<p>Out-of-date production facilities</p> <p>Ineffective safety and employee training programs</p> <p>Poorly maintained or inadequate equipment</p> <p>Employees ignore safety policies or procedures</p> <p>Lack of knowledge regarding OSHA laws and regulations</p>	<p>Establish a maintenance program that ensures equipment is adequately maintained. Investigate and resolve employee reports of malfunctioning equipment</p> <p>Appropriately discipline violators of safety policies or procedures</p> <p>Retain competent legal counsel to advise the entity on OSHA requirements. Ensure legal counsel periodically reviews applicable policies, procedures, and safety precautions</p>
3. Minimize insurance, claims, and other risk-related costs while maintaining adequate insurance coverage	O	<p>Inaccurate, insufficient, or untimely information regarding risk-related costs or accidents or incidents that could give rise to an insurance claim</p> <p>Lack of knowledge of risk management cost containment techniques</p>	<p>Ensure that all accidents or other incidents that could give rise to an insurance claim are reported to appropriate personnel</p> <p>Ensure information systems provide information on all risk-related costs, including insurance premiums, self-insured losses, risk management personnel costs and other related costs</p> <p>Ensure that all significant risks pertaining to all activities have been identified and appropriately addressed, for example: product liability, property and casualty, business interruption and loss of key personnel</p> <p>Evaluate insurance coverages and consider opportunities to limit costs through self-insurance, captive or off-shore insurance companies, or other techniques</p> <p>Retain personnel or advisors with risk management training and experience</p>

Activity: Manage Legal Affairs

Objectives	Category O.F.C.	Risks	Points of Focus for Actions/Control Activities
1. Ensure the entity complies with all laws and regulations	C	<p>Management is unaware of legal and regulatory requirements</p> <p>Legal counsel is unaware of all activities taking place within the entity</p>	<p>Retain legal counsel with applicable industry experience</p> <p>Legal counsel periodically communicates with management about legal and regulatory requirements</p> <p>Review of all significant contracts and agreements by legal counsel</p> <p>Review of subsidiary, division, or unit annual business plans by legal counsel</p> <p>Legal counsel attends management meetings, visits business locations away from the executive offices, or otherwise establishes adequate communication with subsidiary, division, or unit management to gain a thorough understanding of enterprise activities</p> <p>Encourage regular communication between legal counsel and the internal and independent auditors, and with the board of directors and its various committees</p> <p>Legal counsel monitors new laws, regulations, court decisions or other events that could impact the entity</p>
2. Ensure contracts and agreements are clear, fair to the entity and legally enforceable	O	Changing legal and regulatory requirements	<p>Legal counsel does not review contracts or agreements</p> <p>Limit personnel authorized to execute contracts or agreements to responsible officials at an appropriate management level</p>
3. Minimize litigation costs and settlements	O	Inaccurate information or estimates regarding costs of litigation or anticipated settlements	<p>Nonlegal personnel are unaware that certain circumstances could potentially lead to litigation</p> <p>Implement training programs for appropriate nonlegal personnel that address situations requiring communication with legal personnel</p> <p>Include a clause in all contracts and agreements requiring copies of all legal notices or correspondence from other parties be sent to legal counsel</p> <p>Monitor costs of current and previous litigation</p> <p>Gather information on recent settlements or awards in similar litigation</p>

Activity: Plan

Objectives	Category O,F,C	Risks	Points of Focus for Actions/Control Activities
1. Develop long- and short-range plans that are in accordance with entity-wide objectives	O	Lack of awareness of entity-wide objectives	<p>Establish a planning approach that uses as its foundation entity-wide objectives</p> <p>Communicate entity-wide objectives to appropriate personnel involved in the planning process</p> <p>Join industry and trade associations</p> <p>Attend seminars or other informative sessions offered by outside parties</p> <p>Retain experienced and competent management</p>
2. Develop plans in a format that allows management to manage the business and measure progress on a timely basis	O	Insufficient information regarding available opportunities	<p>Establish information systems that present plan information in the same format as historical information</p> <p>Monitor and evaluate the effectiveness of plans. Enhance plan formats to emphasize critical success factors</p>
3. Develop plans using an efficient approach	O	Inadequate management information systems	<p>Require agreement on entity-wide objectives before specific plans are developed. When allocating resources, prioritization should be made in accordance with entity-wide objectives</p> <p>Develop and maintain planning system and communicate to all relevant departments. Conduct training when appropriate</p>
4. Develop plans that are realistic	O	Plan formats are ineffective in providing necessary benchmarks against which performance can be measured	<p>Gather information for plans in accordance with the business focus used for managing the business</p> <p>Develop and follow timetable for gathering, analyzing, and consolidating planning information</p> <p>Review and test the validity of assumptions</p> <p>Consider all operational support activities when developing plans</p> <p>Appropriate staff are involved in developing plans</p>

Activity: Process Accounts Payable

Objectives	Category <u>O.F.C.</u>	Risks	Points of Focus for Actions/Control Activities
1. Accurately record invoices on a timely basis for all accepted purchases that have been authorized and only for such purchases	O,F	Missing documents or information	<p>Prenumber and account for purchase orders and receiving reports</p> <p>Match invoice, receiving, and purchase order information and follow up on missing or inconsistent information</p> <p>Follow up on unmatched open purchase orders, receiving reports, and invoices and resolve missing, duplicate, or unmatched items, by individuals independent of purchasing and receiving functions</p>
2. Identify available discounts	O	Inaccurate input of data	Use of control totals or one-for-one checking
3. Accurately record returns and allowances for all authorized credits, and only for such credits	F	Invalid accounts payable fraudulently created for unauthorized or nonexistent purchases	Restrict ability to modify data
		Missing or untimely receipt of documents	Reconcile vendor statements to accounts payable items
		Missing documents or information	Investigate unmatched information before due date
			Maintain accounts payable ledger by discount date
			Prenumber and account for shipping orders for returned goods
			Match shipping orders for returned goods with vendors' credit memos
			Follow up on unmatched shipping orders for returned goods and related receiving reports and invoices and resolve missing, duplicate, or unmatched items, by individuals independent of accounts payable function
			Review vendor correspondence authorizing returns and allowances
		Inaccurate input of data	Reconcile accounts payable records with vendor statements
			Use of control totals or one-for-one checking

Activity: Process Accounts Payable

<u>Objectives</u>	<u>Category</u> <u>O,F,C</u>	<u>Risks</u>	<u>Points of Focus for Actions/Control Activities</u>
4. Ensure completeness and accuracy of accounts payable	O,F	Unauthorized input for nonexistent returns Unauthorized additions to accounts payable	Reconcile accounts payable subsidiary ledger with purchase and cash disbursement transactions Resolve differences between the accounts payable subsidiary ledger and the accounts payable control account
5. Safeguard accounts payable records	O,F	Unauthorized access to accounts payable records and stored data	Restrict access to accounts payable and files used in processing payables Restrict access to mechanical check signers and signature plates

Activity: Process Accounts Receivable

<u>Objectives</u>	<u>Category O,F,C</u>	<u>Risks</u>	<u>Points of Focus for Actions/Control Activities</u>
1. All goods shipped are accurately billed in the proper period	O	Missing documents or incorrect information	Use standard shipping or contract terms Communicate nonstandard shipping or contract terms to accounts receivable Verify shipping or contract terms before invoice processing Identify shipments as being before or after period-end by means of a shipping log and prenumbered shipping documents Reconcile goods shipped to goods billed
2. Accurately record invoices for all authorized shipments and only for such shipments	O,F	Missing documents or incorrect information	Prenumber and account for shipping documents and sales invoices Match orders, shipping documents, invoices and customer information, and follow through on missing or inconsistent information Mail customer statements periodically and investigate and resolve disputes or inquiries, by individuals independent of the invoicing function Monitor number of customer complaints regarding improper invoices or statements (performance indicator) Authorize credit memos by individuals independent of accounts receivable function Prenumber and account for credit memos and receiving documents
3. Accurately record all authorized sales returns and allowances and only such returns and allowances	O,F	Inaccurate input of data	Match credit memos and receiving documents and resolve unmatched items by individuals independent of the accounts receivable function Mail customer statements periodically and investigate and resolve disputes or inquiries, by individuals independent of the invoicing function Review correspondence authorizing returns and allowances Reconcile accounts receivable subsidiary ledger with sale and cash receipts transactions
5. Safeguard accounts receivable records	O,F	Unauthorized access to accounts receivable records and stored data	Resolve differences between the accounts receivable subsidiary ledger and the accounts receivable control account Restrict access to accounts receivable files and data used in processing receivables

Activity: Process Funds

Objectives	Category O.F.C.	Risks	Points of Focus for Actions/Control Activities
1. Accurately forecast cash balances to maximize short-term investment income and to avoid cash "shortfalls"	O	Inaccurate, untimely, or unavailable information regarding cash inflows and outflows	Information systems identify all sources of cash and dates cash is due or expected to be collected (such sources include accounts receivable collections, customer deposits, sale of assets, loan proceeds, and other cash sources)
2. Ensure necessary financing is available in the event of a cash "shortfall"	O	Lack of awareness regarding financing alternatives	Information systems identify all cash requirements and dates cash is needed (such requirements include accounts payable, loan payments, payrolls, dividends or other cash requirements) Identify all internal sources of information Compare information used to prepare cash forecasts with supporting records or underlying documents to verify information is internally consistent
3. Optimize return on temporary cash investments	O	Failure to establish or maintain appropriate relationships with financing sources	Retain financial personnel experienced in obtaining financing for similar entities Identify professional advisors who can assist in locating alternative sources of financing and consult those advisors as appropriate
3. Optimize return on temporary cash investments	O	Lack of knowledge regarding investment alternatives	Establish relationships with financing sources before financing is needed. Maintain proper and current relationships to facilitate access to cash as the need arises
4. Accelerate cash collections	O	Handling cash receipts internally can delay deposit of such receipts	Retain financial personnel experienced in short-term investments
4. Accelerate cash collections	O	Customers delay remittance	Use professional investment advisors
4. Accelerate cash collections	O	Handling cash receipts internally can delay deposit of such receipts	Consider "lock-box" arrangements whereby payments are remitted to a post office box and the bank collects and deposits such remittances
4. Accelerate cash collections	O	Excessive accounts receivable collection problems	Factor accounts receivable
4. Accelerate cash collections	O	Customers delay remittance	Honor bank credit cards
4. Accelerate cash collections	O	Customers delay remittance	Offer discounts for timely remittance
4. Accelerate cash collections	O	Customers delay remittance	Establish and enforce collection policies
4. Accelerate cash collections	O	Customers delay remittance	Monitor accounts receivable for overdue balances; implement collection procedures on a timely basis
4. Accelerate cash collections	O	Excessive accounts receivable collection problems	Establish and enforce a credit policy that reflects an appropriate balance between risk of credit loss and sales volume

Activity: Process Funds

Objectives	Category <u>O,F,C</u>	Risks	<u>Points of Focus for Actions/Control Activities</u>
5. Record cash receipts on accounts receivable completely and accurately	O,F	Cash received is diverted, lost, or otherwise not reported accurately to accounts receivable	Assign opening of mail to an individual with no responsibility for or access to files or documents pertaining to accounts receivable or cash accounts; compare listed receipts to credits to accounts receivable and bank deposits Consider use of lock-box or other arrangements to accelerate deposits Consider ability to have customers transfer funds electronically to the entity's bank account, and notify the entity of payment through Electronic Data Interchange (EDI) Send periodic statements to customers and investigate customer-noted differences (performance indicator) Reconcile general ledger with accounts receivable subsidiary records; investigate differences Contact payor to determine reasons for payment, or payment different than amounts invoiced
6. Manage timing of cash disbursements	O	Inaccurate, untimely, or unavailable information regarding payment due dates Bills are paid before due dates Checks clear the bank quickly	Information system identifies all cash requirements and dates cash is needed Use accounts payable aging analysis Delay check preparation or signature until the due date Release check at the latest possible time and at the end of a day or week, if possible Consider check-clearing time when selecting a bank
7. Minimize cash disbursements	O	Information system does not identify available discounts and related required payment dates	Information system identifies payment dates related to available discounts
8. Disburse cash only for authorized purchases	O,F	Fictitious documentation is created Reuse of supporting documents	Examine supporting documents, payments approved by individuals independent of procurement, receiving, and accounts payable Cancel supporting documents to prevent resubmission for payment

Activity: Process Funds

Objectives	Category <u>O.F.C.</u>	Risks	Points of Focus for Actions/Control Activities
9. Remit disbursements to vendors and others, such as for dividends, debt service, and tax or other payments, in a timely and accurate manner	O,F	Inaccurate, untimely, or unavailable information regarding amounts or due dates of payments	<p>Detailed comparison of actual versus budgeted disbursements</p> <p>Compare payment amounts and recipients with source documents, such as vendor invoices, purchase orders, tax returns, dividend computations, loan repayment schedules, or other appropriate documentation; verify accuracy of supporting documents</p> <p>Establish a "tickler file" to identify payment due dates</p> <p>Modify information systems as necessary to provide payment information</p>
10. Record cash disbursements completely and accurately	O, C	Missing documents or information	<p>Match disbursement records against accounts payable/open invoice files</p> <p>Prenumber and account for checks</p>
11. Safeguard cash and the related accounting records	O,F	Inadequate physical security over cash and documents that can be used to transfer cash	<p>Reconcile bank statements to cash accounts and investigate long-outstanding checks by individuals independent of accounts payable and cash disbursement functions</p> <p>Segregate custodial and record-keeping functions</p> <p>Reconcile bank accounts by individuals without responsibility for cash receipts, disbursements or custody</p> <p>Receive and prelist cash by individuals independent of recording cash receipts</p> <p>Restrictively endorse checks on receipt</p> <p>Deposit receipts intact daily</p> <p>Restrict access to accounts receivable files and files used in processing cash receipts</p> <p>Mail checks by individuals independent of recording accounts payable</p> <p>Authorized check signers are independent of cash receipts functions</p> <p>Physically protect mechanical check signers and signature plates</p> <p>Restrict access to accounts payable files and files used in processing cash disbursements</p>

Activity: Process Fixed Assets

<u>Objectives</u>	Category <u>O,F,C</u>	<u>Risks</u>	<u>Points of Focus for Actions/Control Activities</u>
1. Completely and accurately record fixed asset transfers, acquisitions, dispositions and related depreciation	O,F	Acquisition documentation may be lost or otherwise not communicated to proper personnel	<p>Prenumber individual capital expenditure authorizations and investigate missing documents</p> <p>Route copy of purchase orders for capital expenditures to personnel who process fixed assets; investigate purchase orders not matched with receiving documentation after anticipated receipt date</p> <p>Reconcile fixed asset additions with capital expenditure authorizations</p> <p>Inquire of purchasing or other personnel to clarify asset description or function</p> <p>Establish clear definitions for asset categories</p> <p>Dispose of or transfer fixed assets only with proper authorization, a copy of which is provided to appropriate personnel</p> <p>Prenumber fixed asset disposal and transfer authorization forms and investigate missing documents</p> <p>Count fixed assets periodically, reconcile count with fixed asset records and investigate differences</p>
2. Safeguard fixed assets from loss through theft	O	<p>Acquired assets may not be adequately described</p> <p>Asset disposals or transfers may not be communicated to proper personnel</p> <p>Incorrect depreciation lives or methods may be used</p>	<p>Establish policies regarding depreciation lives and methods, communicate them to appropriate personnel, and periodically review them to ensure continued appropriateness</p> <p>Review depreciation detail for accuracy and compliance with policies and procedures</p> <p>Restrict access to facilities during non-working hours</p> <p>Affix an identification plate and number to office furniture and fixtures, equipment and other portable fixed assets</p> <p>Develop, implement and communicate safeguarding policies</p>

Activity: Analyze and Reconcile

Objectives	Category <u>O,F,C</u>	Risks	<u>Points of Focus for Actions/Control Activities</u>
1. Compare operating results with pre-established standards, such as budgets or prior-period results. Identify variances, trends, or unusual changes and their causes	O	Pre-established standards are not determined Lack of or inaccurate information needed to compare actual results with pre-established standards	Periodically establish operating standards, such as quarterly or annual budgets Specify information needed to identify and explain variances, trends or unusual changes Design information systems to communicate necessary information to appropriate people on a timely basis
2. Reconcile books and records to ensure their internal consistency	O,F	(Note: Risks for this objective vary, depending on the reconciliation procedures and the nature of the information being reconciled. Accordingly, reconciliation procedures are identified, where appropriate, in other sections of this Reference Manual)	

Activity: Process Benefits and Retiree Information

Objectives	Category <u>O.F.C.</u>	Risks	Points of Focus for Actions/Control Activities
1. Ensure all eligible individuals, and only such individuals, are included in benefit programs	O, C	<p>Program eligibility requirements are not clearly communicated to appropriate personnel</p> <p>Inaccurate employee information is provided to benefits personnel</p> <p>Eligible employees are improperly excluded from participation</p> <p>Nonexistent employees are entered as program participants or beneficiaries</p>	<p>Train and update appropriate personnel regarding plan eligibility requirements and amendments thereto</p> <p>Compare information to employee personnel file or otherwise verify its accuracy</p> <p>Limit access to employee data base</p>
2. Accurately calculate benefits due to each participant	O, C	<p>Plan benefit provisions are unclear or complex</p>	<p>Periodically match participant list to employee and/or retiree list and to documentation of employees' elections not to participate</p> <p>Periodically compare participant list to employee and/or retiree list</p> <p>Approval by an authorized official of all additions to participant data base</p> <p>Verify existence and status of participant</p>
3. Summarize and track benefit information	O	<p>Errors are made in calculating benefits</p>	<p>Ensure plan documents describe benefit provisions clearly and include sample calculations</p> <p>Amend plan as necessary to clarify benefit computations</p> <p>Consult legal, actuarial, or other professionals as needed to clarify benefit provisions</p> <p>Standardize forms or programs for calculating benefits</p> <p>Review benefit calculations</p>
4. Comply with applicable laws and regulations	C	<p>Personnel are unaware of applicable laws and regulations</p>	<p>Limit access to information and data used in calculating benefits</p> <p>Approve all changes to data bases used to calculate benefits</p> <p>Reconcile various related reports</p> <p>Use logs or other devices to ensure completeness of processing</p> <p>Train human resource or other personnel on applicable laws and regulations</p>
5. Generate and distribute benefits reports in an accurate and timely manner	O	<p>Lack of adequate systems</p>	<p>Review and approve all plan documents and policies by legal counsel experienced in employee and retiree benefit programs</p> <p>Ensure that report generation systems process information accurately and satisfy reporting deadlines</p>
		<p>Lack of understanding of reporting requirements</p>	<p>Implement and monitor training programs</p>

Activity: Process Payroll

Category
O,F,C

Objectives

Risks

Points of Focus for Actions/Control Activities

<p>1. Pay employees in accordance with wage contracts and other established policies</p>	<p>O</p> <p>System is not designed to reflect payment schedule included in collective bargaining agreements or individual agreements with employees</p>	<p>Implement payment schedule that reflects wage contracts and agreed-upon payment schedules</p>
<p>2. Calculate and record payroll (including payroll deductions) accurately and completely for all services actually performed and approved, and only for such services</p>	<p>O,F</p> <p>Pay rates or deductions are not properly authorized or are inaccurate</p>	<p>Review and approve initial pay and any subsequent additions or changes</p> <p>Periodically verify payroll data base information</p> <p>Review and approve initial deductions/benefit elections</p> <p>Use standard forms for making changes to payroll information</p> <p>Review and approve all nonstandard items such as sick, vacation and bonus pay</p> <p>Review payroll register and checks for reasonableness</p> <p>Security controls that limit access to payroll data base</p> <p>Review and approve time records for unusual or nonstandard hours and for overtime</p> <p>Use standardized policies and procedures when hiring employees</p> <p>Security procedures relating to additions and deletions of employees to or from the data base</p> <p>Maintain logs or other documentation supporting or tracking changes to payroll data base</p> <p>Where practical, require valid identification and employee signature to receive paycheck</p> <p>Prohibit payment of wages in cash, except in prescribed circumstances</p> <p>Use direct deposit systems</p> <p>Verify that source documents such as timecards are received for all employees</p> <p>Maintain back-up records of employees' time in case source documents are lost</p> <p>Reconcile the employee subsidiary ledger to the general ledger control accounts; investigate any differences</p> <p>Compare total hours and number of employees input with the totals in the payroll register</p>

Activity: Process Payroll

Objectives	Category <u>O.F.C.</u>	Risks	Points of Focus for Actions/Control Activities
3. Restrict access to payroll data information to only those individuals who need such information to discharge duties	O	Unauthorized personnel may gain access to payroll information	Access to information stored on electronic media is restricted by frequently changed passwords
4. Provide payroll information to relevant personnel to satisfy management information needs	O	Management information needs with respect to payroll are not defined	Payroll processing systems and written information are subject to physical security Identify how payroll information can satisfy other management objectives and link information sources

Activity: Process Tax Compliance

Objectives	Category <u>O,F,C</u>	Risks	Points of Focus for Actions/Control Activities
1. Accurately process, prepare and file required tax documents on a timely basis	F,C	Inadequate information about, or understanding of, filing requirements and applicable laws and regulations	<p>Employ competent tax professionals--either in-house or outside the entity--to identify and prepare filings</p> <p>Subscribe to tax services and/or maintain membership in appropriate industry, trade, or professional organizations to identify emerging tax requirements or opportunities</p> <p>Establish a system, such as a "tickler file," to identify tax filing due dates</p>
2. Reduce tax liabilities to the legal minimum	O, C	<p>Incomplete or inaccurate information used as the basis for document preparation</p> <p>Inadequate information regarding tax- savings opportunities</p>	<p>Identify information necessary to prepare tax documents; ensure information systems are designed to accurately provide such information on a timely basis</p> <p>Ensure tax professionals are fully informed of all aspects of the entity's operations, including routine and nonroutine transactions, and any changes in the entity's business lines or methods of conducting business</p>
3. Record the effect of all tax transactions or economic events completely and accurately	F,C	<p>Inadequate information about, or understanding of, financial reporting of tax transactions or economic events</p> <p>Journal entries related to tax transactions or economic events are not properly approved or posted to the general ledger</p>	<p>Periodically review tax filings and status to specifically identify tax-savings opportunities</p> <p>Employ personnel who understand financial reporting for taxes</p> <p>Subscribe to technical service and/or maintain memberships in appropriate industry, trade, or professional organizations that identify and explain new or existing financial reporting requirements</p> <p>Journal entries related to taxes are approved by authorized and knowledgeable officials</p> <p>Each journal entry is compared with the general ledger to ensure proper posting</p>

Activity: Process Product Costs

Objectives	Category <u>O.F.C.</u>	Risks	Points of Focus for Actions/Control Activities
1. Develop standard costs of producing products, including costs at each stage of the production process	O,F	Inadequate or inaccurate information	<p>Identify information necessary to develop standard product costs; ensure information systems accurately provide such information on a timely basis (this information may include such items as units planned to be produced, budgeted labor hours and costs, budgeted overhead costs, and estimated material costs; it should take into account the impact of technology on the manufacturing process and consider the proper basis on which to allocate costs)</p> <p>Periodically evaluate the production process and estimate the costs associated with each stage of the process</p> <p>See the Operations section of this Reference Manual</p> <p>Clearly define and organize each stage of production; appropriately document such stages</p> <p>Establish systems to routinely identify stage of completion; periodically verify system is functioning properly</p> <p>Prenumber and account for the numerical sequence of requisitions of materials and component parts issued to and returned from production; investigate missing or duplicate (unmatched) items by people independent of the materials handling function</p> <p>Reconcile records of labor and overhead charges to payrolls and overhead cost incurred; investigate differences</p> <p>Prenumber and account for the numerical sequence of production reports or other records of finished production and transfers within work-in-process; reconcile those reports to quantities recorded; investigate missing documents and differences</p> <p>Review and approve monthly summarizing entries</p> <p>Maintain perpetual inventory records</p> <p>Periodically balance the raw materials, work-in-process, and finished goods records (previous balance plus additions less transfers out, compared with the current total)</p> <p>Periodically count raw materials, work-in-process, and finished goods inventories and compare with the perpetual records; investigate differences</p> <p>Reconcile the perpetual records to the general ledger control accounts, and approve adjustments, by personnel other than those responsible for maintaining related perpetual records or for safeguarding inventories</p>
2. Record actual costs incurred completely and accurately	O,F	<p>Poorly organized production process</p> <p>Inability to identify the stage of production</p> <p>Inaccurate, untimely, or unavailable information regarding actual costs incurred</p>	<p>See the Operations section of this Reference Manual</p> <p>Clearly define and organize each stage of production; appropriately document such stages</p> <p>Establish systems to routinely identify stage of completion; periodically verify system is functioning properly</p> <p>Prenumber and account for the numerical sequence of requisitions of materials and component parts issued to and returned from production; investigate missing or duplicate (unmatched) items by people independent of the materials handling function</p> <p>Reconcile records of labor and overhead charges to payrolls and overhead cost incurred; investigate differences</p> <p>Prenumber and account for the numerical sequence of production reports or other records of finished production and transfers within work-in-process; reconcile those reports to quantities recorded; investigate missing documents and differences</p> <p>Review and approve monthly summarizing entries</p> <p>Maintain perpetual inventory records</p> <p>Periodically balance the raw materials, work-in-process, and finished goods records (previous balance plus additions less transfers out, compared with the current total)</p> <p>Periodically count raw materials, work-in-process, and finished goods inventories and compare with the perpetual records; investigate differences</p> <p>Reconcile the perpetual records to the general ledger control accounts, and approve adjustments, by personnel other than those responsible for maintaining related perpetual records or for safeguarding inventories</p>

Activity: Process Product Costs

<u>Objectives</u>	<u>Category O,F,C</u>	<u>Risks</u>	<u>Points of Focus for Actions/Control Activities</u>
3. Determine variances from standard costs and their effect on inventory and cost of sales	O,F	Variances are computed or recorded inaccurately	Compute variances for each appropriate product; verify completeness by comparison to product list or other appropriate document Verify variance accuracy by recomputation or other appropriate methods Review general ledger or other records to ensure variances are recorded accurately

Activity: Provide Financial & Management Reporting

<u>Objectives</u>	<u>Category</u> O,F,C	<u>Risks</u>	<u>Points of Focus for Actions/Control Activities</u>
1. Provide timely and accurate information needed by management and others to discharge their responsibility	O	<p>Information needs of management or others is unknown or not clearly communicated</p> <p>Due dates and relative priorities of management reports are not clarified or communicated</p>	<p>Identify user information needs and update such needs periodically</p> <p>Communicate information needs from users to preparers of management reports</p> <p>Determine due dates for all management reports, whether routine or nonroutine</p> <p>Establish relative priorities for all management reports, whether routine or nonroutine</p> <p>Communicate management report due dates and priorities to report preparers and users</p> <p>Establish "tickler files" or other system to ensure due dates are routinely identified</p>
2. Prepare external financial reports on a timely basis and in compliance with applicable laws, regulations, rules or contractual agreements	F,C	<p>Information systems are incapable of providing necessary information</p> <p>Information systems cannot provide necessary information in a timely manner</p> <p>Personnel are unaware of applicable laws, regulations, rules or contractual agreements</p>	<p>Identify and implement necessary systems changes</p> <p>Retain competent personnel who are knowledgeable of, and have experience with, applicable laws, regulations or rules affecting the entity's external financial reporting</p> <p>Review of significant contractual agreements by management or supervisory personnel responsible for preparation of external financial reports</p>
3. Maintain confidentiality of financial information	O, C	<p>Unauthorized personnel have access to financial information</p>	<p>Restrict report or information distribution to authorized personnel; periodically review and update distribution lists</p>

SAMPLE FILLED-IN TOOLS

This section presents the evaluation tools presented in blank form earlier, filled-in for ABC Company, a hypothetical medium-size aerospace parts manufacturer. ABC Company recently acquired Laker Parts, a smaller company in the same industry. The italicized entries illustrate how an evaluator might complete these tools.

CONTROL ENVIRONMENT

Points of Focus

Description/Comments

Integrity and Ethical Values

Management must convey the message that integrity and ethical values cannot be compromised, and employees must receive and understand that message. Management must continually demonstrate, through words and actions, a commitment to high ethical standards.

- **Existence and implementation of codes of conduct and other policies regarding acceptable business practice, conflicts of interest, or expected standards of ethical and moral behavior.** For example, consider whether:
 - Codes are comprehensive, addressing conflicts of interest, illegal or other improper payments, anti-competitive guidelines, insider trading.
 - Codes are periodically acknowledged by all employees.
 - Employees understand what behavior is acceptable or unacceptable, and know what to do if they encounter improper behavior.
 - If a written code of conduct does not exist, the management culture emphasizes the importance of integrity and ethical behavior. This may be communicated orally in staff meetings, in one-on-one interface, or by example when dealing with day-to-day activities.

The company does not have a formal code of conduct, but expectations of employee conduct are included in a manual. This is provided to all new employees.

- **Establishment of the "tone at the top" – including explicit moral guidance about what is right and wrong – and extent of its communication throughout the organization.** For example, consider whether:
 - Commitment to integrity and ethics is communicated effectively throughout the enterprise, both in words and deeds.
 - Employees feel peer pressure to do the right thing, or cut corners to make a "quick buck."
 - Management appropriately deals with signs that problems exist, e.g., potential defective products or hazardous wastes, especially when the cost of identifying problems and dealing with the issues could be large.

Management expects all employees to maintain high moral and ethical standards, and to conduct themselves accordingly. Management is conscious of setting an example through words and actions. This is done anecdotally and sporadically. Management's expectations are communicated to all employees in the manual, and expected to be reinforced by supervisors and workers alike.

Points of Focus

- Dealings with employees, suppliers, customers, investors, creditors, insurers, competitors, and auditors, etc. (e.g., whether management conducts business on a high ethical plane, and insists that others do so, or pays little attention to ethical issues). For example, consider whether:
 - Everyday dealings with customers, suppliers, employees and other parties are based on honesty and fairness (e.g., customer's overpayment or a supplier's underbilling are not ignored, no efforts are made to find a way to reject an employee's legitimate claim for benefits, and reports to lenders are complete, accurate and not misleading).
- Appropriateness of remedial action taken in response to departures from approved policies and procedures or violations of the code of conduct. Extent to which remedial action is communicated or otherwise becomes known throughout the entity. For example, consider whether:
 - Management responds to violations of behavioral standards.
 - Disciplinary actions taken as a result of violations are widely communicated in the entity. Employees believe that, if caught violating behavioral standards, they'll suffer the consequences.
- Management's attitude towards intervention or overriding established controls. For example, consider whether:
 - Management has provided guidance on the situations and frequency with which intervention may be needed.
 - Management intervention is documented and explained appropriately.
 - Manager override is explicitly prohibited.
 - Deviations from established policies are investigated and documented.
- Pressure to meet unrealistic performance targets -- particularly for short-term results -- and extent to which compensation is based on achieving those performance targets. For example, consider whether:
 - Conditions such as extreme incentives or temptations exist that can unnecessarily and unfairly test people's adherence to ethical values.
 - Compensation and promotions are based solely on achievement of short-term performance targets.
 - Controls are in place to reduce temptations that might otherwise exist.

Description/Comments

Management maintains a high degree of integrity in its dealings, and requires its employees and agents to maintain similar levels. Departures from this requirement are dealt with quickly and severely; there are examples on file of actions taken with individuals and with regard to general communications. Few complaints alleging misconduct have been received from customers or others. Periodically, the CEO speaks with key customers and suppliers regarding their views of treatment by company personnel, and receives positive reactions.

Departures that surface from policies and procedures or violations of behavior expectations are immediately dealt with in a manner commensurate with the infraction. Such remedial actions range from oral reminders of company policy to termination.

Management has not attempted to override or bypass controls improperly. Employees are encouraged to report attempts to override controls, and management has supported individuals who have done so by recognizing this on their appraisals.

Executives are salaried, and usually receive an additional cash bonus approximating 20% of salary largely related to achieving specific personal or activity objectives. As a result, management's compensation is based primarily on their individual and joint performance and that of the activity in which they work. Management believes that this compensation plan encourages individual initiative and teamwork. Because short-term compensation is only indirectly based on profitability, management has little incentive to manipulate operations or financial statements to improve operating results.

CONCLUSIONS/ACTIONS NEEDED

Management has demonstrated its commitment to integrity and ethical behavior and has communicated that commitment to all employees. The message is continual but anecdotal. Management should consider a more planned program.

Competence

Management must specify the level of competence needed for particular jobs, and translate the desired levels of competence into requisite knowledge and skills.

- **Existence of formal or informal job descriptions or other means of defining tasks that comprise particular jobs.** For example, consider whether:
 - Management has analyzed, on a formal or informal basis, the tasks comprising particular jobs, considering such factors as the extent to which individuals must exercise judgment and the extent of related supervision.
- **Analyses of the knowledge and skills needed to perform jobs adequately.** For example, consider whether:
 - Management has determined to an adequate extent the knowledge and skills needed to perform particular jobs.
 - Evidence exists indicating that employees appear to have the requisite knowledge and skills.

The Company has formal written job descriptions for all supervisory personnel and, for jobs involving only few specific tasks, job duties are clearly communicated.

The job descriptions specify the knowledge and skills needed, either generally or in terms of the nature and extent of education, training and experience required. The human resources department uses these descriptions in hiring, training and promotion decisions.

CONCLUSIONS/ACTIONS NEEDED

The existence of written job descriptions with defined tasks and parameters (e.g., education, training) demonstrates clear management commitment to competence. Management should consider more formal job descriptions for non-supervisory personnel.

Board of Directors or Audit Committee

An active and effective board, or committees thereof, provides an important oversight function and, because of management's ability to override system controls, the board plays an important role in ensuring effective internal control.

- Independence from management, such that necessary, even if difficult and probing, questions are raised. For example, consider whether:
 - The board constructively challenges management's planned decisions, e.g., strategic initiatives and major transactions, and probes for explanations of past results (e.g., budget variances).
 - A board that consists solely of an entity's officers and employees (e.g., a small corporation) questions and scrutinizes activities, presents alternative views and takes appropriate action if necessary.
- Use of board committees where warranted by the need for more in-depth or directed attention to particular matters. For example, consider whether:
 - Board committees exist.
 - They are sufficient, in subject matter and membership, to deal with important issues adequately.

The board of directors consists of four outside directors and three senior officers of the company. Two of the outside directors are business associates of the CEO and chairman. The secretary and other board meeting guests report lively discussions between management and certain outside directors.

The board has an audit committee, composed of three outside directors, and a compensation committee, composed of the four outside directors.

Points of Focus

- **Knowledge and experience of directors.** For example, consider whether:
 - Directors have sufficient knowledge, industry experience and time to serve effectively.
- **Frequency and timeliness with which meetings are held with chief financial and/or accounting officers, internal auditors, and external auditors.** For example, consider whether:
 - The audit committee meets privately with the chief accounting officer and internal and external auditors to discuss the reasonableness of the financial reporting process, system of internal control, significant comments and recommendations, and management's performance.
 - The audit committee reviews the scope of activities of the internal and external auditors annually.
- **Sufficiency and timeliness with which information is provided to board or committee members, to allow monitoring of management's objectives and strategies, the entity's financial position and operating results, and terms of significant agreements.** For example, consider whether:
 - The board regularly receives key information, such as financial statements, major marketing initiatives, significant contracts or negotiations.
 - Directors believe they receive the proper information.
- **Sufficiency and timeliness with which the board or audit committee is apprised of sensitive information, investigations, and improper acts (e.g., travel expenses of senior officers, significant litigation, investigations of regulatory agencies, defalcations, embezzlement or misuse of corporate assets, violations of insider trading rules, political payments, illegal payments).** For example, consider whether:
 - A process exists for informing the board of significant issues.
 - Information is communicated timely.

Description/Comments

Most board members are experienced business people. One, who owns 12% of the outstanding common stock, is a physician who lacks direct management experience. All board members who are also officers of the company have extensive aerospace industry experience, as does one of the outside directors.

The company's internal audit manager, a recent hire, meets quarterly with the audit committee. The audit committee meets with the external auditors at least twice each year -- during audit planning and upon completion of the audit. The CFO is a director, and has frequent interaction with other directors.

The board members are provided monthly financial statements -- including a comparison of current-year actual results to budget and the prior year -- as well as certain operating statistics and analyses. These are given by the fifteenth of each month in sufficient detail to allow meaningful analysis prior to the Board meetings. Board meetings are held on the last Friday of each month. Board approval is required for expenditures over \$250,000, and to accept any sales orders over \$1,000,000. Board approval of sales orders is normally received during special meetings conducted by telephone.

Company policy dictates that the board be notified, by certified mail, within three business days of any litigation deemed likely to result in loss of over \$100,000, any regulatory investigation, or defalcation, embezzlement or other improper act of any employee or officer at or above the manager level. Any such act by an employee below the manager level that results in a company loss in excess of \$2,000 is reported to the board. Officer expense accounts and perks are reviewed by the board semiannually.

Points of Focus

Description/Comments

- **Oversight in determining the compensation of executive officers and head of internal audit, and the appointment and termination of those individuals.** For example, consider whether:
 - The compensation committee approves all management incentive plans tied to performance.
 - The compensation committee, in joint consultation with the audit committee, deals with compensation and retention issues regarding the chief internal auditor.
- **Role in establishing the appropriate "tone at the top."** For example, consider whether:
 - The board and audit committee are involved sufficiently in evaluating the effectiveness of the "tone at the top."
 - The board takes steps to ensure an appropriate "tone."
 - The board specifically addresses management's adherence to the code of conduct.
- **Actions the board or committee takes as a result of its findings, including special investigations as needed.** For example, consider whether:
 - The board has issued directives to management detailing specific actions to be taken.
 - The board oversees and follows up as needed.

The compensation committee annually determines the compensation of the CEO and the head of internal audit.

The board encourages management to establish and enforce high ethical and moral standards. The outside directors do not actively participate in establishing those standards, though they do monitor management's compliance with those standards.

The board ordinarily leaves follow-up to management's discretion, and rarely conducts special investigations.

CONCLUSIONS/ACTIONS NEEDED

The board of directors and audit committee contribute meaningfully to the effectiveness of the control environment. Management should strive, however, to involve the board more closely in special investigations.

Management's Philosophy and Operating Style

The philosophy and operating style of management normally have a pervasive effect on an entity. These are, of course, intangibles, but one can look for positive or negative signs.

- **Nature of business risks accepted, e.g., whether management often enters into particularly high-risk ventures, or is extremely conservative in accepting risks.** For example, consider whether:
 - Management moves carefully, proceeding only after carefully analyzing the risks and potential benefits of a venture.

Management is relatively risk averse, being conservative in its business practices. The company's debt to equity ratio is among the lowest in the industry; business acquisitions are researched thoroughly, evidenced by the plan developed for the Laker Parts acquisition, which analyzed competition, markets, pricing structure and vendor and customer relationships. Capital acquisitions are financed initially through existing bank credit lines with permanent financing provided by collateralized long-term borrowings. The company recently retained outside consultants to consider how to better control medical plan and workers' compensation costs.

- **Personnel turnover in key functions, e.g., operating, accounting, data processing, internal audit.** For example consider whether:
 - There has been excessive turnover of management or supervisory personnel.
 - Key personnel have quit unexpectedly or on short notice.
 - There is a pattern to turnover (e.g., inability to retain key financial or internal audit executives) that may be an indicator of the emphasis that management places on control.

Personnel turnover has been at satisfactory levels for many years. There was greater turnover at Laker Parts immediately prior to acquisition; such turnover was apparently related to the pending sale of the company, and was not considered a problem by management because it did not involve key skills.

- **Management's attitude toward the data processing and accounting functions, and concerns about the reliability of financial reporting and safeguarding of assets.** For example, consider whether:
 - The accounting function is viewed as a necessary group of "bean counters," or as a vehicle for exercising control over the entity's various activities.
 - The selection of accounting principles used in financial statements always result in the highest reported income.

The information systems department consists of 10 full-time employees, including two experienced managers who report to the CFO, with a current budget of \$3 million -- sufficient for its needs.

Project estimates, such as costs to complete open contract jobs, are prepared by knowledgeable personnel and reviewed and

Points of Focus

- . If the accounting function is decentralized, operating management "sign off" on reported results.
- . Unit accounting personnel also have responsibility to central financial officers.
- . Valuable assets, including intellectual assets and information, are protected from unauthorized access or use.
- **Attitudes and actions toward financial reporting, including disputes over application of accounting treatments (e.g., selection of conservative versus liberal accounting policies; whether accounting principles have been misapplied, important financial information not disclosed, or records manipulated or falsified).** For example, consider whether:
 - . Management avoids obsessive focus on short-term reported results.
 - . Personnel do not submit inappropriate reports to meet targets (e.g., salespeople submitting orders to meet targets, knowing customers will return goods in the next period).
 - . Managers do not ignore signs of inappropriate practices.
 - . Estimates do not stretch facts to the edge of reasonableness and beyond.
- **Frequency of interaction between senior management and operating management, particularly geographically removed division or subsidiary management.** For example, consider whether:
 - . Senior managers frequently visit subsidiary or divisional operations.
 - . Group or divisional management meetings are held frequently.

CONCLUSIONS/ACTIONS NEEDED

Management's philosophy and operating style are conducive to effective internal control.

Description/Comments

approved by appropriate operating and financial management.

All financial reports are reviewed by the controller, the CFO and the CEO before release. Annual financial statements are reviewed by the board of directors before release.

Management wants financial reports to be accurate and fairly presented. Occasional disagreements arise between operating and financial management and between the company and the external auditors, but management and the auditors work together to determine proper accounting treatments. Such disagreements do not result in an adversarial relationship with the auditors.

Senior management and operating management have frequent interaction in both formal and informal settings, such as weekly management meetings and informal lunches. ABC has only one location.

Organizational Structure

The organizational structure shouldn't be so simple that it cannot adequately monitor the enterprise's activities nor so complex that it inhibits the necessary flow of information. Executives should fully understand their control responsibilities and possess the requisite experience and levels of knowledge commensurate with their positions.

- **Appropriateness of the entity's organizational structure, and its ability to provide the necessary information flow to manage its activities.** For example, consider whether:
 - The organizational structure is appropriately centralized or decentralized, given the nature of the entity's operations.
 - The structure facilitates the flow of information upstream, downstream and across all business activities.
- **Adequacy of definition of key managers' responsibilities, and their understanding of these responsibilities.** For example, consider whether:
 - Responsibilities and expectations for the entity's business activities are communicated clearly to the executives in charge of those activities.
- **Adequacy of knowledge and experience of key managers in light of responsibilities.** For example, consider whether:
 - The executives in charge have the required knowledge, experience and training to perform their duties.

The organizational structure of the company has recently been modified to accommodate the divestiture of the defense division and the acquisition of Laker Parts. Management believes the new structure is appropriate. However, the new structure has not been in place long enough to evaluate its effectiveness.

Key managers' responsibilities have been redefined recently in conjunction with the new organizational structure. Such responsibilities appear adequate for the company's needs, but have not been tested over an extended period. Managers' performance indicates they understand their responsibilities, which are reviewed with them annually.

All officers have been with the company for at least five years, except for one former Laker executive, and all are highly knowledgeable of the industry and their responsibilities. Certain managers (i.e., controller and director of manufacturing) at Laker Parts joined the company within the last six months, but held similar positions with other companies in the aerospace industry.

Points of Focus

Description/Comments

- **Appropriateness of reporting relationships.** For example, consider whether:
 - Established reporting relationships -- formal or informal, direct or matrix -- are effective, and they provide managers information appropriate to their responsibilities and authority.
 - The executives of the business activities have access to communication channels to senior operating executives.
- **Extent to which modifications to the organizational structure are made in light of changed conditions.** For example, consider whether:
 - Management periodically evaluates the entity's organizational structure in light of changes in the business or industry.
- **Sufficient numbers of employees exist, particularly in management and supervisory capacities.** For example, consider whether:
 - Managers and supervisors have sufficient time to carry out their responsibilities effectively.
 - Managers and supervisors work excessive overtime, and are fulfilling the responsibilities of more than one employee.

Reporting relationships are logical, and each activity manager reports to the proper company officer. Reporting relationships ensure effective communication between employees, supervisors, managers and officers.

The organizational structure is assessed on an as-needed basis. For example, after the acquisition of Laker Parts, modifications such as integrating administrative functions and consolidating purchasing activities were made to streamline operations.

Because of the recent merger with Laker Parts, ABC has more employees than needed. Layoffs are occurring, but management carefully considers who is terminated and the effect the layoffs may have on control. Management evaluates employees' workload, particularly those with supervisory and key control responsibilities, to ensure they are able to discharge their responsibilities effectively.

CONCLUSIONS/ACTIONS NEEDED

The company's organizational structure and reporting relationships are logical and fit the company's activities. However, the recent changes require close monitoring of the effectiveness and appropriateness of the structure in the near term. Pending layoffs as a result of the Laker Parts acquisition must be monitored for effects on supervisory and key control responsibilities.

Assignment of Authority and Responsibility

The assignment of responsibility, delegation of authority and establishment of related policies provide a basis for accountability and control, and set forth individuals' respective roles.

- **Assignment of responsibility and delegation of authority to deal with organizational goals and objectives, operating functions and regulatory requirements, including responsibility for information systems and authorizations for changes.** For example, consider whether:
 - . Authority and responsibility are assigned to employees throughout the entity.
 - . Responsibility for decisions are related to assignment of authority and responsibility.
 - . Proper information is considered in determining the level of authority and scope of responsibility assigned to an individual.

- **Appropriateness of control-related standards and procedures, including employee job descriptions.** For example, consider whether:
 - . Job descriptions, for at least management and supervisory personnel, exist.
 - . They contain specific references to control-related responsibilities.

- **Appropriate numbers of people, particularly with respect to data processing and accounting functions, with the requisite skill levels relative to the size of the entity and nature and complexity of activities and systems.** For example, consider whether:
 - . The entity has an adequate workforce -- in numbers and experience -- to carry out its mission.

Management delegates authority based on the individual's job responsibilities, knowledge, skill and past performance. For example, only the CFO has the perspective necessary to determine if requested program changes to information systems are feasible and required. Accordingly, only he can authorize such changes. In sales, only experienced personnel are assigned to service the large aircraft manufacturers. They are given significant, but not absolute, authority to negotiate contracts, make concessions or take other actions they deem necessary to ensure customer satisfaction. All significant assignment of responsibility and delegation of authority is reviewed by appropriate senior officers.

Job standards and control responsibilities are reviewed annually by each vice president and activity manager. The CEO annually considers the appropriateness of reporting relationships through the activity manager level.

Because of the recent acquisition of Laker Parts, there are more accounting personnel than necessary. Management is planning to consolidate the accounting activities and is currently evaluating personnel requirements. The information systems department consists of two managers, four programmers and four operators, all of whom are well-trained and competent. This staffing appears adequate for future needs.

Points of Focus

Description/Comments

- **Appropriateness of delegated authority in relation to assigned responsibilities.**
For example, consider whether:
 - There is an appropriate balance between authority needed to "get the job done" and the involvement of senior personnel where needed.
 - Employees at the "right" level are empowered to correct problems or implement improvements, and empowerment is accompanied by appropriate levels of competence and clear boundaries of authority.

Job responsibilities are commensurate with needs and skills. Decision making is pushed down to reasonable levels, with sufficient involvement of superiors as needed.

CONCLUSIONS/ACTIONS NEEDED

Authority and responsibility are appropriately established and reviewed by senior management.

Human Resource Policies and Practices

Human resource policies are central to recruiting and retaining competent people to enable the entity's plans to be carried out so its goals can be achieved.

- **Extent to which policies and procedures for hiring, training, promoting, and compensating employees are in place.** For example, consider whether:
 - Existing personnel policies and procedures result in recruiting or developing competent and trustworthy people necessary to support an effective internal control system.
 - The level of attention given to recruiting and training the right people is appropriate.
 - When formal documentation of policies and practices does not exist, management communicates expectations about the type of people to be hired or participates directly in the hiring process.

The human resources department has established policies and procedures for hiring, training, promoting and compensating employees. Such policies and procedures are reviewed and modified, as needed, at least annually. Also, the VP-Human Resources is responsible for monitoring compliance with the established human resource policies and procedures throughout the company and reports on compliance annually to the Board.

Points of Focus

- **Extent to which people are made aware of their responsibilities and expectations of them.** For example, consider whether:
 - New employees are made aware of their responsibilities and management's expectations of them.
 - Supervisory personnel meet periodically with employees to review job performance and suggestions for improvement.
- **Appropriateness of remedial action taken in response to departures from approved policies and procedures.** For example, consider whether:
 - Management's response to failures to carry out assigned responsibilities is appropriate.
 - Appropriate corrective action is taken as a result of non-adherence to established policies.
 - Employees understand that ineffective performance will result in remedial consequences.
- **Extent to which personnel policies address adherence to appropriate ethical and moral standards.** For example, consider whether:
 - Integrity and ethical values is a criterion in performance appraisals.
- **Adequacy of employee candidate background checks, particularly with regard to prior actions or activities considered to be unacceptable by the entity.** For example, consider whether:
 - Candidates with frequent job changes or gaps in employment history are subjected to particularly close scrutiny.
 - Hiring policies require investigation for a criminal record.
- **Adequacy of employee retention and promotion criteria and information gathering techniques (e.g., performance evaluations), and relation to the code of conduct or other behavioral guidelines.** For example, consider whether:
 - Promotion and salary increase criteria are detailed clearly so that individuals know what management expects prior to promotions or advancement.
 - Criteria reflect adherence to behavioral standards.

Description/Comments

All new supervisory employees are provided written job descriptions which explain their responsibilities. Additionally, they are evaluated annually, and performance goals for the following year are established. Their responsibilities are reviewed with them during this evaluation. Supervisors communicate job duties to personnel who report to them.

Departures from policies and procedures or violations of behavioral expectations are dealt with in a manner commensurate with the infraction. Remedial actions can range from oral reminders of company policy to additional training to termination.

Adherence to ethical standards is a factor specifically addressed on the annual performance evaluation form, and must be considered in the evaluation process.

For all prospective employees, at least three references, business and personal, are contacted. Employees hired at a supervisor or higher level are interviewed by an industrial psychologist.

All employees must comply with the company's behavioral expectations to retain their jobs. Candidates for promotion to supervisor or higher level must have demonstrated a commitment to ethical standards through their own actions, and by setting an example for other employees. Information is accumulated primarily through the performance evaluation process, and less formally through memos or comments submitted by supervisors or peers. Comments indicating departure from behavioral standards are

Points of Focus

Description/Comments

investigated before being considered in retention or promotion decisions.

CONCLUSIONS/ACTIONS NEEDED

Personnel policies and practices are appropriate.

COMPONENT SUMMARY - CONCLUSIONS/ACTIONS NEEDED

Management has a commitment to integrity, ethical behavior and competence. The board's involvement in the company's activities is generally appropriate, though it could be more involved in special investigations. Management's philosophy and operating style are appropriate as are the organizational structure and assignment of authority and responsibility. Management must continue to monitor the effects of the acquisition of Laker Parts, especially the revised organizational structure and pending layoffs. Personnel policies and practices are adequate.

RISK ASSESSMENT

Points of Focus

Description/Comments

Entity-wide Objectives

For an entity to have effective control, it must have established objectives. Entity-wide objectives include broad statements of what an entity desires to achieve, and are supported by related strategic plans. Describe the entity-wide objectives and key strategies that have been established.

The objectives, as documented in ABC's business plan and confirmed by management, are:

- Operations - Become a leader in providing high-quality aerospace parts critical to flight-safety. Within five years, reach a two percent share of the domestic market and a 10 percent share of the foreign market.
- Earn an 18 percent return on total investment.
- Provide employees challenging opportunities and stable employment.

Financial Information - Issue timely financial statements that comply with generally accepted accounting principles

Compliance - Comply with the letter and the spirit of all applicable laws and regulations.

- **Extent to which the entity-wide objectives provide sufficiently broad statements and guidance regarding what the entity desires to achieve, which are specific enough to relate directly to this entity.** For example, consider whether:
 - Management has established entity-wide objectives.
 - The entity-wide objectives are different than generic objectives that could apply to any entity (e.g., generate sufficient cash flow to service debt, or produce a reasonable return on investment).

These objectives state what this company wants to achieve in terms of quality, market, market share and return on investment. These are necessarily broad statements, yet tailored to this company. They provide direction and guidance for management and employees.

- **Effectiveness with which the entity-wide objectives are communicated to employees and board of directors.** For example, consider whether:
 - Information on the entity-wide objectives is disseminated to employees and the board of directors.
 - Management obtains feedback from key managers, other employees and the board signifying that communication to employees is effective.

These objectives are included in our annual business plan, distributed to employees and discussed at the annual employees' meeting and in various departmental and unit meetings. The board of directors helps to establish entity-wide objectives and approves the business plan.

Points of Focus

Description/Comments

- **Relation and consistency of strategies with entity-wide objectives.** For example, consider whether:
 - . The strategic plan supports the entity-wide objectives.
 - . It addresses high level resource allocations and priorities.
- **Consistency of business plans and budgets with entity-wide objectives, strategic plans and current conditions.** For example, consider whether:
 - . Assumptions inherent in the plans and budgets reflect the entity's historical experience and current conditions.
 - . Plans and budgets are at an appropriate level of detail for each management level.

Strategic plans (driving at producing to strict tolerances in a total quality program, and directing marketing resources to key players and influencers) support the operations objectives.

The company's five-year business plan is updated annually by management and is approved by the board. It reflects implementation strategies for achieving the stated company-wide objectives. Part of the annual updating of the business plan includes identifying departmental and unit objectives, and establishing detailed operating and capital expenditure budgets. Departmental and unit managers are actively involved in establishing objectives and budgets. All plans and budgets are reviewed and approved by senior management, assuring that plans and budgets are consistent with one another, and reflect historical experience and current economic industry conditions.

CONCLUSIONS/ACTIONS NEEDED

The company-wide objectives and strategies are set at an appropriate level and are linked, addressing what the entity is to achieve and how it will be achieved.

Activity-level Objectives

Activity-level objectives flow from and are linked with the entity-wide objectives and strategies. Activity-level objectives are frequently stated as goals with specific targets and deadlines. Objectives should be established for each significant activity, and those activity-level objectives should be consistent with each other.

- **Linkage of activity-level objectives with entity-wide objectives and strategic plans.** For example, consider whether:
 - . Adequate linkage exists for all significant activities.
 - . Activity-level objectives are reviewed from time to time for continued relevance.

Activity-level objectives are based on and flow from the entity-wide objectives and strategic plans. Unit heads present activity objectives to their vice president who ensures the linkage with the entity-wide objectives. For instance, with emphasis on producing high quality parts critical to flight-safety, vendor qualification requirements were modified to highlight quality considerations; and receiving department procedures, employee head count, training requirements and equipment acquisitions were all modified to reflect the increased importance of material testing. Production processes were altered, and additional quality assurance personnel hired.

- **Consistency of activity-level objectives with each other.** For example, consider whether:
 - . They are complementary and reinforcing within activities.
 - . They are complementary and reinforcing between activities.

Activity-level objectives are designed to support achievement of entity-wide objectives. To ensure consistency, senior management reviews objectives of all activities for which they are responsible. The CEO also reviews activity-level objectives to provide a broad perspective and to ensure consistency.

- **Relevance of activity-level objectives to all significant business processes.** For example, consider whether:
 - . Objectives are established for key activities in the flows of goods and services and support activities.
 - . Activity-level objectives are consistent with past practices and performances or with industry or functional analogues, or the reasons for variance has been considered.

Supervised by the appropriate vice president, each department annually reviews its participation in business processes to ensure they support activity-level objectives. Specific attention is devoted to adequacy of information and to the appropriateness of each employee's activities. Activity-level objectives are consistent with the company's objectives and practices of the last four years. Companies

- Objectives are established for each significant activity. These activities may include, among others (the activities listed derive from a generic business model, pages 46 to 49; illustrative objectives for each of these activities are presented in a reference manual, pages 51 to 94)

Inbound
 Operations
 Outbound
 Marketing and Sales
 Service
 Procurement
 Technology Development
 Human Resources
 Manage the Enterprise
 Manage External Relations
 Provide Administrative Services
 Information Technology
 Manage Risk (of accident or other insurable loss)

Manage Legal Affairs
 Plan
 Process Accounts Payable
 Process Accounts Receivable
 Process Funds
 Process Fixed Funds
 Analyze and Reconcile
 Process Benefits and Retiree Information
 Process Payroll
 Process Tax Compliance
 Process Production Costs
 Provide Financial and Management Reporting

within the industry share similar objectives and practices.

Each department or unit develops objectives in conjunction with the annual business plan update. See pages 139 to 149 for analysis of "Inbound" activities. [Similar analyses for other activities are not shown.]

- **Specificity of activity-level objectives.** For example, consider whether:
 - Objectives include measurement criteria.
- **Adequacy of resources relative to objectives.** For example, consider whether:
 - Management has identified the resources needed to achieve the objectives.
 - Plans exist for acquiring necessary resources (e.g., financing, personnel, facilities, technology).
- **Identification of objectives that are important (critical success factors) to achievement of entity-wide objectives.** For example, consider whether:
 - Management has identified what must go right, or where failure must be avoided, for entity-wide objectives to be achieved.
 - Capital spending and expense budgets are based on management's analysis of the relative importance of objectives.
 - The objectives serving as critical success factors provide a basis for particular management focus.

Activity-level objectives are as specific as possible. They are defined in a manner that makes determination of objective achievement a fairly simple matter.

Business plans and budgets are based on and drive needs and allocations. They also serve as a "reality check" on new initiatives. For instance, the business plan for developing a line of navigational equipment indicated that the necessary financial and management resources could be obtained only at unacceptably high cost and risk. Accordingly, the plan was discarded.

The company has prioritized activity-level objectives into three categories -- critical, important and supportive. These prioritizations are reviewed regularly and whenever a changed condition requires modification of objectives or how the company does business.

Points of Focus

Description/Comments

- **Involvement of all levels of management in objective-setting and extent to which they are committed to the objectives. For example, consider whether:**
 - **Managers participate in establishing activity objectives for which they are responsible.**
 - **Procedures exist to resolve disagreements.**
 - **Managers support the objectives, and do not have "hidden agendas."**

All managers are involved in establishing entity-wide objectives. Final decisions are made by senior management (CFO, manufacturing and marketing vice presidents), after considering the managers' input. Modifications to activity-level objectives are discussed by the appropriate vice president and unit manager. Unresolved issues are addressed by the CEO. Unit plans are modified as necessary based on the final objectives.

CONCLUSIONS/ACTIONS NEEDED

Activity-level objectives are linked to the entity-wide objectives. Managers' involvement in developing the activity-level objectives contributes to establishing achievable goals.

Risks

An entity's risk-assessment process should identify and consider the implications of relevant risks, at both the entity level and the activity level. The risk-assessment process should consider external and internal factors that could impact achievement of the objectives, should analyze the risks, and provide a basis for managing them.

■ **Adequacy of mechanisms to identify risks arising from external sources.** For example, consider whether management considers risks related to:

- Supply sources
- Technology changes
- Creditor's demands
- Competitor's actions
- Economic conditions
- Political conditions
- Regulation
- Natural events

Management obtains input on entity risks from industry consultants and analysts, lawyers, external auditors and board members. Management's assessment of key risks follows:

Risk: Vendor's inability to supply materials that consistently meet the Company's production specifications.

The Company has an effective quality control function and monitors each vendor's performance. Procedures at the Inbound Activity level are adequate to address this risk.

Risk: Insufficient vendor production capacity to meet the Company's demand for materials.

Several major vendors are available to meet the Company's supply needs. Appears to be little exposure to a shortage of suppliers. The Company's Purchasing Activity monitors available vendors.

Risk: Significant jump in material costs due to changes in demand or economic conditions.

Material costs do fluctuate periodically in response to changes in commodities prices. Company should consider using futures contracts for certain materials to hedge costs increases.

Risk: Federal Trade Commission investigation of Laker Parts acquisition for possible restraint of trade.

The Company projects having a 2% and 10% share of the domestic and foreign markets, respectively. An unfavorable ruling is unlikely.

Risk: Assessments from the Internal Revenue Service's examination of "open" federal income tax returns.

Tax returns for the three previous years are open for IRS examination. The Company maintains conservative tax practices and has established reserves for possible tax assessments.

Risk: FAA may place further onerous requirements on production of replacement parts used in the airline industry.

It is likely that the FAA will require replacement parts to be more durable. Research and development is currently considering alternative production processes and materials. We are probably slightly ahead of competitors in this regard.

Risk: A major competitor's penetration of foreign markets as a result of its recent acquisition of a West German company, jeopardizing ABC's achieving a 10% share of the foreign market within five years.

Sales and Marketing Activities are considering this factor in developing strategies to penetrate foreign markets and achieve the Company's growth objectives.

Risk: Pentagon cutbacks on defense spending could result in excess production capacity.

ABC has a 3-year backlog of government contracts. No immediate impact of government spending reductions.

Risk: Economic and political conditions could curb commercial airline travel and reduce demand for new aircraft.

Airline travel may fall during the next several years but demand for parts should remain strong, due to a large backlog for new aircraft and an aging airline fleet. No significant impact is expected.

Risk: An unstable U.S. dollar coupled with increased sales to foreign companies could result in foreign currency exchange losses.

Consider hedging foreign currency transactions.

Risk: ABC's major competitors have modernized production processes and reduced their labor force by 15%. The Company has been slow to do likewise.

This needs immediate attention, or there could be a risk of losing business.

Risks from internal sources are evaluated. Management's assessment of such risks follows:

Risk: The Company may experience short-term cash flow problems because of its recent acquisition of Laker Parts and its plans to increase cash dividends to shareholders.

Projections show that combining Laker Parts and ABC will result in annual cash savings of approximately \$2.8 million per year, starting third quarter this year. Cash flow from operations of approximately \$2.5 million is sufficient to service the acquisition debt. Capital expenditures are being financed through long-term collateralized financing. The Company has additional borrowing capacity, as evidenced by an unused \$4.5 million revolving line of credit. No further actions are necessary to control this risk.

- **Adequacy of mechanisms to identify risks arising from internal sources.** For example, consider whether management considers risks related to:
 - Human resources, such as retention of key management personnel or changes in responsibilities that can affect the ability to function effectively.
 - Financing, such as availability of funds for new initiatives or continuation of key programs.
 - Labor relations, such as compensation and benefit programs to keep the entity competitive with others in the industry.
 - Information systems, such as the adequacy of back-up systems in the event of failure of systems that could significantly affect operations.

Risk: Profit margins on certain product lines are shrinking.

ABC is shifting the emphasis on certain product lines, moving away from lower-margin products to higher-margin, flight-safety-critical parts. In addition, expanding markets in Europe offer new opportunities. The business plan addresses these issues, and performance to plan should be closely monitored. No additional actions are necessary.

Risk: Labor strife.

ABC foresees no labor problems. The union workforce is fully staffed with experienced and capable people. Relations with the Company's in-house labor bargaining unit are good. The union contract is scheduled to be renegotiated in 1992. No action needed.

Risk: Because of the recent acquisition of Laker Parts, selected administrative positions have been eliminated, creating uncertainty among some employees about long-term job security.

Management has taken steps to limit fallout from these layoffs:

- . Management has communicated why the layoffs were necessary, and provided evidence that they relate solely to the acquisition and not to long-term business problems.
- . Terminated employees were given generous severance packages.
- . Supervisory personnel are monitoring employee morale.

Risk: Integrating the operations and information systems of Laker Parts could disrupt existing operations (e.g., manufacturing, quality assurance and marketing).

The Vice President-Operations has been charged with the responsibility of integrating the Laker

Parts operation. The integration plan, approved by the CEO, includes deadlines and performance measures. The status of integration and any deviation from schedule is reported weekly.

■ **Identification of significant risks for each significant activity-level objective.** (Consider risks identified with respect to each of the activities identified under "activity-level objectives"; illustrative risks relative to common objectives are presented in the reference manual, pages 51 to 94.)

- **Thoroughness and relevance of the risk analysis process, including estimating the significance of risks, assessing the likelihood of their occurring, and determining needed actions.** For example, consider whether:
 - Risks are analyzed through formal processes or informal day-to-day management activities.
 - The identified risks are relevant to the corresponding activity objective.
 - Appropriate levels of management are involved in analyzing the risks.

Business plans and budgets for key activities relate activity-level objectives to risks and action plans. See pages 139 to 149. [Similar analyses for other activities are not shown.]

As noted, the business planning and budgeting process includes analyzing risks that might affect the company. Senior management also has monthly meetings to discuss recent events and how the company might be affected.

CONCLUSIONS/ACTIONS NEEDED

The company's process for identifying and analyzing risk is adequate based on the nature of the company's operations. Items identified as needing attention include:

- Consider techniques to hedge cost increases for certain materials.
- Immediately assess progress on modernizing production processes.
- Monitor integration and market/product-shift projects.

Managing Change

Economic, industry and regulatory environments change and entities' activities evolve. Mechanisms are needed to identify and react to changing conditions.

- **Existence of mechanisms to anticipate, identify and react to routine events or activities that affect achievement of entity or activity-level objectives (usually implemented by managers responsible for the activities that would be most affected by the changes).** For example, consider whether:
 - Routine changes are addressed as part of the normal risk identification and analysis process, or through separate mechanisms.
 - Risks and opportunities related to the changes are addressed at sufficiently high levels in the organization so their full implications are identified and appropriate action plans formulated.
 - All activities within the entity significantly affected by the change are brought into the process.

- **Existence of mechanisms to identify and react to changes that can have a more dramatic and pervasive effect on the entity, and may demand the attention of top management.** For example, for each of the following areas of potential change, consider whether:
 - Changed operating environment:
 - Market research or other programs identify major shifts in customer demographics, preferences or spending patterns.
 - The entity is aware of significant shifts in the work force -- externally or internally -- that could affect available skill levels.
 - Legal counsel periodically updates management on the implications of new legislation.

New personnel:

- Special action is taken to ensure new personnel understand the entity's culture and perform accordingly.
- Consideration is given to key control activities performed by personnel being moved.

Functional managers identify routine events or changing conditions affecting their spheres of responsibility. Management holds semimonthly meetings where identified changes are discussed and action plans are formulated. Follow-up occurs at subsequent meetings, with decisions made regarding the need for new controls.

Management uses a variety of mechanisms to identify events or activities that may affect achievement of objectives. These include reviewing business and industry publications, participation in industry associations, and use of consultants and other professionals to acquire specific information. Outside counsel monitors legal developments that could affect the company. Top management monitors changes in the national economy and the health of the aircraft industry (e.g., new orders, backlogs, types of aircraft being ordered, changing technologies, employment levels) through an industry reporting service. Activities of competitors are monitored through trade association affiliations, frequent interaction with the aircraft manufacturers and analysis of competitor proposal bids.

The company has had little turnover, especially in key control functions. All new employees or executives (e.g., from Laker Parts) in such key positions are carefully supervised initially to

Points of Focus

New or redesigned information systems:

- Mechanisms exist to assess the effects of new systems.
- Procedures are in place to reconsider the appropriateness of existing control activities when new computer systems are developed and go "live."
- Management knows whether systems development and implementation policies are adhered to despite pressures to "short-cut" the process.
- Attention is given to the effect of new systems on information flows and related controls, and employee training, including focus on employee resistance to change.

Rapid growth:

- Systems capability is upgraded to handle rapidly increasing volumes of information.
- Work force in operations, accounting and data processing is expanded as needed to keep pace with increased volume.
- A process for revising budgets or forecasts exists.
- A process exists for considering interdepartmental implications of revised unit objectives and plans.

New technology:

- Information on technological developments is obtained through reporting services, consultants, seminars or perhaps joint ventures with companies in the forefront of research and development relevant to the entity.
- New technologies, or applications, developed by competitors are monitored.
- Mechanisms exist for taking advantage, and controlling the use, of new technology applications, incorporating them into production processes or information systems.

New lines, products, activities and acquisitions:

- The ability exists to reasonably forecast operating and financial results.
- The adequacy of existing information systems and control activities for the new line, product or activity is assessed.
- Plans are developed for recruiting and training people with the requisite expertise to deal with new products or activities.
- Procedures are in place to track early results, and to modify production and marketing as needed.

Description/Comments

ensure the appropriateness of their actions and focus.

The Vice President of Engineering/Research monitors new technologies that can be incorporated in the company's products, or are being developed by competitors. Such technologies are brought to the attention of senior management and the board. The Vice President of Operations monitors technological developments that could be used in the manufacturing process, and the CFO and Information Systems manager identify new technologies that can be incorporated in the company's information systems. Implementation plans are developed by department or activity managers and senior management, and approved by the board of directors.

When considering development of new product lines, considerable attention is given to customer demand, production capabilities, profitability implications, information systems needs, etc. The "new product development" form provides the discipline for focusing on these issues.

Staff reassignments or reductions as a result of the Laker Parts acquisition are approved by the vice president responsible for each activity. Managers and supervisors have been told to be particularly sensitive to signs of possible morale problems. Management has held employee meetings to explain the reasons for the reductions and to emphasize the strength and stability of ABC, Inc. Unit managers meet individually with their V.P. to decide what action might be needed to alleviate morale problems.

Because the company plans on expanding its penetration of the European market, we have hired local personnel with substantial aviation experience to lead operations in key countries,

Points of Focus

Description/Comments

- . Financial reporting, legal and regulatory requirements are identified and compiled with.
- . The effects on other company products, and on profitability, are monitored.
- . Overhead allocations are modified to reflect product contribution accurately.

including the U.K., Germany and France. Their responsibilities include monitoring changes in the industry and business community, focusing particularly on the unification of the European Community.

Corporate restructuring:

- . Staff reassignments or reductions are analyzed for their potential effect on related operations.
- . Transferred or terminated employees' control responsibilities are reassigned.
- . Impact on morale of remaining employees, after major downsizing considered.
- . Safeguards exist to protect against disgruntled former employees.

Foreign operations:

- . Management keeps abreast of the political, regulatory, business and social culture of areas in which foreign operations exist.
- . Personnel are made aware of accepted customs and rules.
- . Alternative procedures exist in case activities of or communication mechanisms with foreign operations are interrupted.

CONCLUSIONS/ACTIONS NEEDED

Controls to identify and react to changes are adequate.

Continue to watch for potential morale weakness from former Laker Parts employees. Consider having human resources periodically survey attitudes and monitor performance.

COMPONENT SUMMARY - CONCLUSIONS/ACTIONS NEEDED

The procedures for linking company-wide objectives with activity-level objectives are appropriate. Manager involvement at all levels contributes to establishing achievable goals. Risk assessment processes for identifying and analyzing risks are appropriate, as are the mechanisms to monitor changing conditions.

Management should consider techniques to mitigate risk of price fluctuation for certain materials. Management should also determine how to speed progress in modernizing plant facilities. Morale weakness from the Laker Parts acquisition should continue to be monitored.

CONTROL ACTIVITIES

Points of Focus

Description/Comments

Control activities encompass a wide range of policies and the related implementation procedures that help ensure that management's directives are effected. They help assure that those actions identified as necessary to address risks to achieve the entity's objectives are carried out.

- **Existence of appropriate policies and procedures necessary with respect to each of the entity's activities.**

All relevant objectives and associated risks for each significant activity should have been identified in conjunction with evaluating Risk Assessment. Reference may be made to the Reference Manual (pages 43 to 94) which presents, for common business activities, illustrative objectives, risks, and "actions/points of focus for control activities." The listings in that latter column may be useful in identifying what actions management has directed to address the risks, and considering the appropriateness of control activities the entity applies to see that the actions are carried out. It should be recognized that points of focus for general controls (or general computer controls) are presented in the Reference Manual under the activity "Information Technology."

- **Identified control activities in place are being applied properly.** For example, consider whether:
 - Controls described in policy manuals are actually applied and are applied the way that they're supposed to be.
 - Appropriate and timely action is taken on exceptions or information that require follow-up.
 - Supervisory personnel review the functioning of controls.

Unit managers develop controls relevant to their particular activity's plans and programs. Controls for critical success factors are reviewed by the respective Vice Presidents. See pages 139 to 149 for control activities related to the inbound activity. [Similar analyses for other activities are not shown.]

ABC's policies require, and training programs emphasize the importance of, following up on deviations from expected results or plans to determine the cause for the deviation. Employees are evaluated on their follow-up actions.

COMPONENT SUMMARY - CONCLUSIONS/ACTIONS NEEDED

The company's process for identifying control activities is based on its objectives and risks, and appears to be effective.

Control activities are in place for significant plans and programs. They are responsive to management's needs.

Actions needed with respect to inbound activities:

- . Policies and procedures must be developed to improve the flow of large quantities of materials through receiving and testing.
 - . Consideration should be given to eliminating any overlap in the use of engineering personnel in initial testing.
 - . Management should consider establishing policies to control situations where personnel place undue pressure on receiving to accept materials.
 - . Management should consider providing training on laws and regulations relating to hazardous materials.
-

INFORMATION AND COMMUNICATION

Points of Focus

Description/Comments

Information

Information is identified, captured, processed and reported by information systems. Relevant information includes industry, economic and regulatory information obtained from external sources, as well as internally generated information.

- **Obtaining external and internal information, and providing management with necessary reports on the entity's performance relative to established objectives.** For example, consider whether:
 - Mechanisms are in place to obtain relevant external information -- on market conditions, competitors' programs, legislative or regulatory developments and economic changes.
 - Internally generated information critical to achievement of the entity's objectives, including that relative to critical success factors, is identified and regularly reported.
 - The information that managers need to carry out their responsibilities is reported to them.

The entity-wide strategic plan, developed by management, identifies the internally and externally generated information required to analyze and monitor the entity-wide objectives. Information derived from external sources, such as Dun & Bradstreet, trade association publications and outside counsel, includes industry, economic and regulatory data for analysis of market and industry trends, safety records, market share information and compliance with aviation standards. Internally generated information includes reports of gross margins on various product lines and service quality offered by the Company. (See also Risk Assessment.)

- **Providing information to the right people in sufficient detail and on time to enable them to carry out their responsibilities efficiently and effectively.** For example, consider whether:
 - Managers receive analytical information that enables them to identify what action needs to be taken.
 - Information is provided at the right level of detail for different levels of management.
 - Information is summarized appropriately, providing pertinent information while permitting closer inspection of details as needed rather than just a "sea of data."
 - Information is available on a timely basis to allow effective monitoring of events and activities -- internal and external -- and prompt reaction to economic and business factors and control issues.

Project groups, in liaison with the Information Systems Steering Committee, identify information required by users to run the Company's operations effectively, and are responsible for ensuring that any deficiencies in the current information systems are addressed by the information system initiatives.

Information due dates have been clearly defined and agreed upon by management. Actual performance, including availability and response times, is monitored weekly and reported to the CFO.

Points of Focus

- **Development or revision of information systems based on a strategic plan for information systems – linked to the entity's overall strategy – and responsive to achieving the entity-wide and activity-level objectives.** For example, consider whether:
 - A mechanism (e.g., an information technology steering committee) is in place for identifying emerging information needs.
 - Information needs and priorities are determined by executives with sufficiently broad responsibilities.
 - A long-range information technology plan has been developed and linked with strategic initiatives.

- **Management's support for the development of necessary information systems is demonstrated by the commitment of appropriate resources – human and financial.** For example, consider whether:
 - Sufficient resources (managers, analysts, programmers with the requisite technical abilities) are provided as needed to develop new or enhanced information systems.

Description/Comments

The strategic plan for information systems is developed by the Information Systems Steering Committee, comprising management representatives from each user activity area. The plan is updated annually in conjunction with revisions of the Company's business plan, and on an interim basis whenever significant revisions are made to the business plan, to ensure that information systems continue to support the entity's needs.

Management established the Information Systems Steering Committee, whose members devote substantial time to evaluating the adequacy of existing systems and developing recommended system enhancements.

CONCLUSIONS/ACTIONS NEEDED

Information systems provide management with the information it wants, and on a timely basis, to manage the company effectively.

Communication

Communication is inherent in information processing. Communication also takes place in a broader sense, dealing with expectations and responsibilities of individuals and groups. Effective communication must occur down, across and up an organization and with parties external to the organization.

- **Effectiveness with which employees' duties and control responsibilities are communicated.** For example, consider whether:
 - Communication vehicles -- formal and informal training sessions, meetings, and on-the-job supervision -- are sufficient in effecting such communication.
 - Employees know the objectives of their own activity and how his or her duties contribute to achieving those objectives.
 - Employees understand how their duties affect, and are affected by, duties of other employees.

Following issuance of the annual report, the CEO holds a meeting with employees to review the year's results. He also discusses the company-wide objectives for the coming year, and how management intends to achieve those objectives. Following that meeting, departmental vice presidents meet with unit personnel to explain how the activities of that unit relate to achieving the company-wide objectives.

As part of initial training, all employees are provided with information regarding their duties and how those duties impact other employees in their own and other units. Many employees are cross-trained, which further strengthens this understanding. Each employee receives an annual evaluation, during which his or her responsibilities are discussed, to ensure he or she fully understands them.

- **Establishment of channels of communication for people to report suspected improprieties.** For example, consider whether:
 - There's a way to communicate upstream through someone other than a direct superior, such as an ombudsman or corporate counsel.
 - Anonymity is permitted.
 - Employees actually use the communication channel.
 - Persons who report suspected improprieties are provided feedback, and have immunity from reprisals.

The employee handbook states that suspected violations of company policies or behavioral standards should be reported to a vice president, as described above. Such reports can be made anonymously.

Employees have utilized existing communication channels to report suspected improprieties. Additionally, employees from time to time ask their supervisors for policy interpretations and for guidance when proper actions or behavior is not clearly evident.

The company does not provide feedback to employees who report suspected improprieties, except to thank them for their concern. Employees who report suspected improprieties are immune from reprisals, unless it is discovered (as occurred once) that the report was fabricated and filed with malicious intent. Management encourages employees to report suspected improprieties and has investigated all such reports.

- **Receptivity of management to employee suggestions of ways to enhance productivity, quality, or other similar improvements.** For example, consider whether:
 - Realistic mechanisms are in place for employees to provide recommendations for improvement.
 - Management acknowledges good employee suggestions by providing cash awards or other meaningful recognition.

Senior management is receptive to constructive suggestions regardless of their source. On several occasions, cash awards have been made for particularly good suggestions. Several department managers are not receptive to such suggestions, and are being encouraged to be more open to them.

- **Adequacy of communication across the organization (for example, between procurement and production activities) and the completeness and timeliness of information and its sufficiency to enable people to discharge their responsibilities effectively.** For example, consider whether:
 - Sales people inform engineering, production and marketing of customer needs.
 - Accounts receivable personnel advise the credit approval function of slow payers.
 - Information on competitors' new products or warranties reach engineering, marketing and sales personnel.

Communication between departments or units is generally good. Employees are evaluated on how well they work with other activities. Also, many functions are integrated for purposes of bonus computations. Sales, procurement, inbound and manufacturing, for example, are all evaluated based on a number of factors, including profitability.

Points of Focus

- **Openness and effectiveness of channels with customers, suppliers and other external parties for communicating information on changing customer needs.** For example, consider whether:
 - Feedback mechanisms with all pertinent parties exist.
 - Suggestions, complaints and other input are captured and communicated to relevant internal parties.
 - Information is reported upstream as necessary and follow-up action taken.
- **Extent to which outside parties have been made aware of the entity's ethical standards.** For example, consider whether:
 - Important communications to outside parties are delivered by management level commensurate with the nature and importance of the message (e.g., senior executive periodically explains in writing the entity's ethical standards to outside parties).
 - Suppliers, customers, and others know the entity's standards and expectations regarding actions in dealing with the entity.
 - Such standards are reinforced in routine dealings with outside parties.
 - Inproprieties by employees of external parties are reported to the appropriate personnel.
- **Timely and appropriate follow-up action by management resulting from communications received from customers, vendors, regulators or other external parties.** For example, consider whether:
 - Personnel are receptive to reported problems regarding products, services or other matters, and such reports are investigated and acted upon.
 - Errors in customer billings are corrected, and the source of the error is investigated and corrected.
 - Appropriate personnel -- independent of those involved with the original transactions -- process complaints.
 - Appropriate actions are taken and there is follow-up communication with the original sources.
 - Top management is aware of the nature and volume of complaints.

Description/Comments

Salespeople actively seek feedback from customers as it relates to complaints, design improvement, repair needs, and the like. Input is communicated to the appropriate personnel (e.g., engineering and production) at the bi-weekly joint departmental meetings. Sales and operating management meet with key customers and suppliers periodically to obtain first-hand input.

Management does not formally notify outside parties of ethical standards and expectations. However, the entity has a well-known reputation within the community and the industry of being honest and ethical, and its reputation is reinforced in dealings with outside parties. Letters received by the CEO, as well as input received in discussions with key customers and suppliers, evidence appropriate behavior.

Management follows up quickly on communications from outside parties that indicate problems within the internal control system, or that employees may have acted inappropriately. These external sources are viewed as valuable indicators of potential problems that need to be addressed. Customer complaints and related follow-up actions are reported formally to the CEO. Management requires a response to all external communications, indicating the investigation results, and thanking the initiator for his or her time and effort.

CONCLUSIONS/ACTIONS NEEDED

Generally, communication within the company, and between the company and external parties, is effective. The following items will be considered to enhance effective communication further:

- . Develop a formal corporate code of conduct.
 - . Further encourage department managers to solicit and consider constructive suggestions from personnel at all levels.
-

COMPONENT SUMMARY - CONCLUSIONS/ACTIONS NEEDED

Information and communication policies and procedures are effective. Management should consider developing a formal corporate code of conduct and encouraging department managers to solicit and consider constructive suggestions from personnel.

MONITORING

Points of Focus

Description/Comments

Ongoing Monitoring

Ongoing monitoring occurs in the ordinary course of operations, and includes regular management and supervisory activities, and other actions personnel take in performing their duties that assess the quality of internal control system performance.

- **Extent to which management personnel, in carrying out their regular activities, obtain evidence as to whether the system of internal control continues to function.** For example, consider whether:
 - Operating management compares production, inventory, sales or other information obtained in the course of their daily activities to systems-generated information.
 - Integration or reconciliation of operating information used to manage operations with data generated by the financial reporting system.
 - Operating personnel are required to "sign off" on the accuracy of their units' financial statements, and are held responsible if errors are discovered.

Senior management is actively involved in all operations of the company, and has direct contact with customers, suppliers, production activities, bankers, inventory control, etc. Management frequently challenges financial and Management reports that are inconsistent with its knowledge.

Many of the reports used to manage activities are integrated with the financial reporting system and with reports used by other activities. Because of the integrated nature of the company's information systems, significant differences or inconsistencies are likely to be detected quickly. Operating personnel are expected to identify and report significant inaccuracies, or identify reports they believe may be inaccurate. The Controller's staff also analyzes operating reports and investigates apparent inconsistencies with financial reports.

- **Extent to which communications from external parties corroborate internally generated information, or indicate problems.** For example, consider whether:
 - Customers implicitly corroborate billing data by paying their invoices, or customer complaints about billings -- indicating system deficiencies in the processing of sales transactions -- are investigated for their underlying causes.
 - Communications from vendors and monthly statements of accounts payable are used as a control monitoring technique.

Management follows up on all communications from outside parties that indicate a problem may exist within the company. Particular attention is given to communications from customers, and government agencies, such as the FAA. Monthly vendor statements are reconciled to the recorded accounts payable, and accounts receivable balances are confirmed, on a test basis, at least once a year. Problems are investigated and resolved. Recently, several sales-tax exempt customers complained they were

Points of Focus

Description/Comments

- . Suppliers' complaints of unfair practices by purchasing agents are fully investigated.
- . Regulators communicate information to the entity regarding compliance or other matters that reflect on the functioning of the internal control system.
- . Controls that should have prevented or detected the problems are reassessed.
- **Periodic comparison of amounts recorded by the accounting system with physical assets.** For example, consider whether:
 - . Inventory levels are checked when goods are taken from inventory storage for shipment, and differences between recorded and actual amounts are corrected.
 - . Securities held in trust are counted periodically and compared with existing records.
- **Responsiveness to internal and external auditor recommendations on means to strengthen internal controls.** For example, consider whether:
 - . Executives with proper authority decide which of the auditors' recommendations will be implemented.
 - . Desired actions are followed up to verify implementation.
- **Extent to which training seminars, planning sessions and other meetings provide feedback to management on whether controls operate effectively.** For example, consider whether:
 - . Relevant issues and questions raised at training seminars are captured.
 - . Employee suggestions are communicated upstream and acted on as appropriate.
- **Whether personnel are asked periodically to state whether they understand and comply with the entity's code of conduct and regularly perform critical control activities.** For example, consider whether:
 - . Personnel are required to periodically acknowledge compliance with the code of conduct.
 - . Signatures are required to evidence performance of critical control functions, such as reconciling specified amounts.

inappropriately charged sales tax. Their accounts were corrected, and investigation discovered a flaw in a software update that did not recognize certain exempt codes. The software was fixed, and the program change controls are being reviewed.

Physical inventory counts are made semiannually, and actual amounts are compared with perpetual inventory records. Differences are investigated. Fixed assets are counted and compared with asset listings on a cycle basis, no less than every three years.

Internal and external auditor recommendations are reviewed by senior management and the audit committee. Appropriate follow-up actions are taken and are communicated to the full board, as are the reasons any recommendations are not acted upon.

Management has found that training sessions and other meetings occasionally provide feedback on control effectiveness and participants' understanding of their control responsibility. Appropriate follow-up action is taken.

The company has not developed a formal code of conduct. However, expectations of behavior are outlined in the employee manual, and management regularly reinforces these expectations in both word and action.

Points of Focus

Description/Comments

- **Effectiveness of internal audit activities.** For example, consider whether:
 - There are appropriate levels of competent and experienced staff.
 - Their position within the organization is appropriate.
 - They have access to the board of directors or audit committee.
 - Their scope, responsibilities and audit plans are appropriate to the organization's needs.

The company recently established an internal audit function, headed by an experienced internal auditor with Fortune 500 company experience. He has one staff person at this time.

The audit manager reports to the CFO, and has access to all activities of the company. The audit manager has access to the audit committee, with whom he meets quarterly. If he desires, he may meet with them privately. Internal audit salaries are determined by the CFO, based on his evaluation of their performances, abilities, etc., with the audit committee's approval.

CONCLUSIONS/ACTIONS NEEDED

Internal control monitoring is appropriate and sufficient. Management will consider the benefit of formalizing a code of conduct and requiring periodic employee affirmations that they understand and comply with the code. However, employee compliance with the behavior expectations outlined in the employee manual is high. The internal audit function is new, and is expected to grow and become more effective over time.

Separate Evaluations

It is useful to take a fresh look at the internal control system from time to time, focusing directly on system effectiveness. The scope and frequency of separate evaluations will depend primarily on an assessment of risks, and ongoing monitoring procedures.

- **Scope of and frequency with which separate evaluations of the internal control system are performed.** For example, consider whether:
 - Appropriate portions of the internal control system are evaluated.
 - The evaluations are conducted by personnel with the requisite skills.
 - The scope, depth of coverage and frequency is adequate.

The Information Systems Steering Committee assesses information system effectiveness on a high level. The board focuses on the control environment and monitoring functions, obtaining input from the CFO and the auditors.

Points of Focus

Description/Comments

- **Appropriateness of the evaluation process.** For example, consider whether:
 - The evaluator gains a sufficient understanding of the entity activities.
 - An understanding is obtained of how the system is supposed to work and how it actually does work.
 - An analysis is made, using the evaluation results as measured against established criteria.

- **Whether the methodology for evaluating a system is logical and applicable to the system under assessment.** For example, consider whether:
 - Such methodology includes checklists, questionnaires or other tools.
 - The evaluation team is brought together to plan the evaluation process and ensure a coordinated effort.
 - The evaluation process is managed by an executive with requisite authority.

- **Appropriateness of the level of documentation given the activity under assessment.** For example, consider whether:
 - Policy manuals, organization charts, operating instructions and the like are available.
 - Consideration is given to documenting the evaluation process.

The evaluation process is informal. It includes steps for understanding of and analyzing key controls in place.

The process is informal.

Limited documentation exists in meeting minutes of the Board and the Information Systems Steering Committee.

CONCLUSIONS/ACTIONS NEEDED

Consideration should be given to formalizing the evaluation process, and considering its scope of coverage over time. The new internal auditor plans to perform an initial review of the established evaluation process.

Reporting Deficiencies

Internal control deficiencies should be reported upstream with certain matters reported to top management and the board.

- **Existence of mechanism for capturing and reporting identified internal control deficiencies.** For example, consider whether means exist for obtaining reports on deficiencies:
 - From both internal sources and external sources (e.g., customers, suppliers, auditors, regulators).
 - Resulting from ongoing monitoring or separate evaluations.
- **Appropriateness of reporting protocols.** For example, consider whether:
 - Deficiencies are reported to the person directly responsible for the activity and to a person at least one level higher.
 - Specified types of deficiencies are reported to more senior management and to the board.
- **Appropriateness of follow up actions.** For example, consider whether:
 - The transaction or event identified is corrected.
 - The underlying causes of the problem are investigated.
 - There is follow up to ensure the necessary corrective action is taken.

Policies exist for the capturing and reporting of deficiencies. For example, the marketing department communicates customer complaints upstream to ensure the proper department (e.g., shipping, production) is made aware and takes follow-up actions. Reaction to external auditor reporting of deficiencies is well structured.

Policies clearly identify to whom discovered deficiencies should be reported. Generally, it is to the senior manager of the department under evaluation, regardless of the level of controls being evaluated.

Follow-up actions are monitored and reported back to the senior manager.

CONCLUSIONS/ACTIONS NEEDED

The policies and procedures in place for reporting deficiencies are appropriate.

COMPONENT SUMMARY - CONCLUSIONS/ACTIONS NEEDED

Ongoing monitoring procedures are adequate. Management should consider formalizing a code of conduct. The process for separate evaluations of the internal control system could be formalized. Policies for reporting deficiencies appear to be appropriate.

RISK ASSESSMENT AND CONTROL ACTIVITIES WORKSHEET

NOTE: This evaluation tool is filled in for one activity (inbound) of ABC Company. When evaluating the risk assessment and control activities company-wide, this tool would be completed for all significant activities.

Activity: INBOUND

Objectives	Category O,F,C	Risk Analysis Risk Factors	Likelihood	Actions/ Control Activities/Comments	Other Objectives Affected	Evaluation and Conclusion
<i>Manage Logistics</i>						
1. <i>Materials are to be tested, and either accepted and moved to storage, or rejected and returned for credit on a timely basis.</i>	O	<i>Receipt of large quantities of materials may delay the receiving and testing activities.</i>	<i>Medium-High</i>	1. <i>Production provides a weekly report of those items most critically needed to continue efficient and uninterrupted production. The Director of Procurement/Receiving reviews materials to be tested and prioritizes such materials based on the weekly report.</i>		<i>Policies and procedures are insufficient for timely processing. Policies and procedures must be developed to detail how materials should flow through receiving and testing, in the event large amounts of material being received, and how achievement of the objective is to be monitored. Additionally, using engineering personnel to test materials may create conflicts between testing and engineering, especially if such use negatively affects achievement of engineering objectives.</i>
2. <i>Accurately process all information related to goods received, and make such information available to appropriate activities on a timely basis.</i>	O,F	<i>Information is not entered accurately or on a timely basis.</i>	<i>Medium</i>	2. <i>Certain engineering personnel have been trained and are available for short-term use in testing certain types of materials.</i> 3. <i>Receiving reports are prenumbered, and missing documents are investigated twice weekly.</i> 4. <i>Information from receiving documents is matched to open purchase orders and, subsequently, to the vendor invoice.</i>		<i>Controls are sufficient to achieve the objective.</i>

Objectives	Category O,F,C	Risk Analysis Risk Factors	Likelihood	Actions/ Control Activities/Comments	Other Objectives Affected	Evaluation and Conclusion
3. Ensure purchase orders are filled on a timely basis.	O	Purchase orders are lost or not forwarded to inbound activities.	Medium	6. When the purchase order is generated, the system automatically updates open purchase order records. A hard copy of the prenumbered form is sent to receiving, which reviews open purchase orders weekly, and missing documents are investigated. The electronic records are periodically reviewed to verify their accuracy.		Controls are sufficient to achieve the objective.
4. All materials received are accurately recorded.	O,F	Due-date information is not available.	Medium	7. The system provides the option to sort open purchase orders several ways, including by due date. A weekly report of open purchase orders due is prepared.		
5. Information needs of each activity are reviewed semi-annually, and communicated to information technology personnel. Systems and reports are modified as necessary.		Information needs of various production units are not clearly identified.	Low	5. Information needs of each activity are reviewed semi-annually, and communicated to information technology personnel. Systems and reports are modified as necessary.		
6. Purchase orders are received and recorded accurately.		Actual quantities received may not equal the quantities indicated on the purchase order or vendor shipping documents.	Medium-High	8. Goods received are counted, weighed or otherwise verified as to quantity.	Production #10 (Not Shown)	Controls are sufficient to achieve the objective.

Objectives	Category O,F,C	Risk Analysis Risk Factors	Likelihood	Actions/ Control Activities/Comments	Other Objectives Affected	Evaluation and Conclusion
				<p>9. Receipts are subject to second count, on a random basis, by a receiving department supervisor.</p>		
				<p>10. Quantities received according to the receiving report are matched to the vendor's shipping documentation and to the purchase order. Material shortages are noted on the receiving documentation, and any excess material is refused. In the case of excess material, documentation is signed by the transportation company representative for return to the vendor. Documentation is forwarded to accounts payable for further processing and control activities.</p>		
		<p>Receiving documentation may not be prepared by receiving personnel, or it may be lost.</p>	<p>Low</p>	<p>11. Receiving documents are sequentially prenumbered, and missing documents are investigated weekly.</p>		
				<p>12. Warehouse personnel will not accept material without a copy of appropriate receiving documentation. Material remaining in the receiving department for more than one day is investigated by a receiving supervisor.</p>		

Objectives	Category O,F,C	Risk Analysis Risk Factors	Likelihood	Actions/ Control Activities/Comments	Other Objectives Affected	Evaluation and Conclusion
5. Only materials actually received and accepted are recorded.	O,F	Receiving employees may prepare erroneous receiving reports for materials not actually received.	Low	13. Vendor invoices will not be processed unless matched with proper receiving documentation. Unmatched invoices are investigated promptly.		Controls are sufficient to achieve the objective.
6. All materials returned for vendor credit are accurately recorded.	O,F	Material return documentation may be lost.	Low-Medium	14. Receiving reports must be subject to verification by the receiving department supervisor. 15. Receiving reports must be matched to a material transfer document signed by the authorized party who accepted the materials from the receiving department. Unmatched receiving reports are investigated weekly.		Controls are sufficient to achieve the objective.
		Material return documentation may not be prepared.	Low	16. Material return forms are prenumbered, and missing documents are promptly investigated. 17. If material is returned without preparation of receiving documentation, open purchase orders will be investigated. If receiving documentation is prepared, it will not be matched with material transfer documentation. Such unmatched receiving reports are promptly followed up, as described in #15 above.		

Objectives	Category O.F.C.	Risk Analysis Risk Factors	Likelihood	Actions/ Control Activities/Comments	Other Objectives Affected	Evaluation and Conclusion
Receive	0	Material return documentation may be inaccurate.	Low	18. Material return documentation must be approved by a receiving supervisor who verifies the return document information.		
				19. Common carriers (i.e., trucking companies, UPS, etc.) verify materials being returned and sign documentation indicating their acceptance of such materials.		
7. Only materials properly ordered are accepted.	0	Employees may lack information regarding properly ordered goods.	Low	20. No materials are accepted without a properly authorized purchase order on file in the receiving department.		Controls are sufficient to achieve the objective.
8. Only materials which comply with purchase order specifications are accepted.	0	Material received from vendors may not comply with specifications.	Medium	21. Materials received are tested for compliance with contract or purchase order specifications. All tests are documented in accordance with prescribed procedures and are reviewed by the receiving department supervisor.		Policies and procedures appear adequate to achieve the objective. However, consideration should be given to situations where personnel may place undue pressure on receiving to accept materials (for instance, in cases where shortages of certain key materials threaten the efficiency of or ability to continue production).

Objectives	Category O.F.C.	Risk Analysis Risk Factors	Likelihood	Actions/ Control Activities/Comments	Other Objectives Affected	Evaluation and Conclusion
		<p>Inbound activity personnel do not understand the specifications due to poor communication with procurement.</p>	<p>Low</p>	<p>22. Receiving is provided a copy of the contractor purchase order with specifications clearly indicated. Specifications are matched to vendor documentation and test results before material is forwarded to another department.</p>		
		<p>Testing procedures may become obsolete.</p>	<p>Low-Medium</p>	<p>23. Testing procedures are reviewed and updated annually by the Director of Procurement and the Engineering Manager. The procedures are reviewed and approved by the Vice President - Operations.</p>		
		<p>Testing equipment may become obsolete or inaccurate.</p>	<p>Medium-High</p>	<p>24. Testing equipment is checked and recalibrated every 30 days, or upon the request of the equipment operator, whichever is more frequent.</p>		
				<p>25. Testing equipment is reviewed and recommendations for new equipment are made in conjunction with the review of testing procedures noted in control #123. Approval of new equipment is required of the Vice President - Operations.</p>		

Objectives	Category O,F,C	Risk Analysis Risk Factors	Likelihood	Actions/ Control Activities/Comments	Other Objectives Affected	Evaluation and Conclusion
9. Ensure that materials transferred from receiving to other activities are completely and accurately recorded.	O,F	Proper documentation is not prepared.	Low	28. Material cannot be transferred without transfer documents.		Controls are sufficient to achieve the objective.
26. Test documentation is reviewed by supervisory personnel. Materials used to manufacture parts critical to flight safety are subject to random retesting. Discrepancies noted in retesting are investigated and appropriate follow-up action is taken (retraining, termination if high number of discrepancies are noted and training fails to resolve the problem, etc.).		Inbound activities personnel may not test materials, or may not test them properly.	Low	27. Production personnel monitor problems related to materials failing to meet engineering specifications, and report such results to procurement and appropriate follow-up action is taken.	Production #10 (Not shown)	
29. Transfer documents must be signed by both the receiving employee and the employee accepting the transfer. Both employees verify its completeness and accuracy.		Information may be inaccurate or incomplete.	Medium			

Objectives	Category O,F,C	Risk Analysis Risk Factors	Likelihood	Actions/ Control Activities/Comments	Other Objectives Affected	Evaluation and Conclusion
10. Precious metals are handled and stored in a secure manner to prevent unauthorized access.	O,F	Information may be input inaccurately.	Medium	30. Inventory is counted quarterly. The physical count is compared with perpetual inventory records. Differences are investigated.		
		Precious metals may be stolen.	High	31. Record-keeping of precious metals is performed by an individual independent of those employees responsible for handling and storage of the metals.		Controls are sufficient to achieve the objective.
				32. The precious metals are stored in a locked and guarded location. Surveillance cameras continuously record all entrances and exits of the storage area.		
				33. All packages, briefcases, etc., removed from the facility by employees are subject to inspection by security personnel.		
				34. Physical counts of precious metals are made monthly by individuals with no responsibility for record-keeping or storage of the metals. The counts are reconciled with the perpetual records, and differences investigated.		

Objectives	Category O,F,C	Risk Analysis		Actions/ Control Activities/Comments	Other Objectives Affected	Evaluation and Conclusion
		Risk Factors	Likelihood			
11. Properly transfer all materials requisitioned, and only such materials.	O,F	Inadequate requisition procedures.	Medium	35. Stores personnel transfer materials to operations only on the authority of a properly approved requisition.		Controls are sufficient to achieve the objective.
		Improper materials are transferred.	Medium	36. Both stores and operations personnel verify that proper materials are transferred and both sign transfer documentation.		
12. Completely and accurately record all transfers to and from storage.	O,F	Incomplete or inaccurate information.	Medium	37. Transfer documentation is signed by both stores and operations personnel, who verify its accuracy.		Controls are sufficient to achieve the objective.
				38. Inventory is counted quarterly. Differences from perpetual records are investigated and resolved.		
				39. Transfer documents are prenumbered, with missing documents investigated weekly.		
13. Hazardous materials are handled and stored in compliance with Occupational Safety and Health Administration (OSHA) and other laws and regulations.	C	Employees may disregard hazardous material handling and storage policies and procedures.	Low	40. Employees responsible for handling and storing hazardous materials are closely supervised, and their work reviewed by experienced supervisors. Deviations from specified policy are treated as serious matters, and disciplinary action is swift and severe.		Controls are adequate to achieve the objective. However, employees are not provided periodic training on laws and regulations, nor on handling and storage techniques. This training could provide assurance that employees remain knowledgeable of such laws, regulations and techniques. Additionally, it would help assure that employees remain aware of the importance of complying with company policies.

Objectives	Category O.F.C.	Risk Analysis Risk Factors	Likelihood	Actions/ Control Activities/Comments	Other Objectives Affected	Evaluation and Conclusion
				<p>41. <i>Employees responsible for handling and storing hazardous materials are subject to regular drug testing.</i></p>		
		<p><i>Storage tanks may leak.</i></p>	<p><i>Medium-High</i></p>	<p>42. <i>Storage tanks are inspected annually. Any sign of irregularity is immediately investigated and resolved.</i></p>		
				<p>43. <i>Storage tanks are replaced at 90% of the manufacturer's estimated useful life.</i></p>		
				<p>44. <i>Water and soil samples, taken from near the storage tanks, are tested quarterly to detect leakage. Any sign of irregularity is immediately investigated and resolved.</i></p>		
				<p>45. <i>Monitoring systems to measure pressure in pipelines used to transport hazardous materials are utilized to detect leaks or other potential problems. These systems are inspected quarterly. Any sign of irregularity is immediately investigated and resolved.</i></p>		

Objectives	Category O.E.C.	Risk Analysis Risk Factors	Likelihood	Actions/ Control Activities/Comments	Other Objectives Affected	Evaluation and Conclusion
14. Federal and state Occupational Safety and Health Administration (OSHA) laws and regulations are complied with.	C	Personnel may not be familiar with all OSHA requirements.	Medium	46. Legal counsel, and the Vice President - Operations review policy and procedures quarterly. Such policy and procedures are modified as necessary to comply with OSHA requirements.		Controls are sufficient to achieve the objective.
		OSHA requirements may be violated due to errors, neglect or intentional disregard.	Medium-High	47. Legal counsel observes execution of company policies and procedures on a regular basis. Questionable acts are immediately investigated and appropriate follow-up action is taken.		
				48. Employees are encouraged to report any suspected violations to the office of the CEO. Employees of the office of the CEO follow-up on such communication.		

OVERALL INTERNAL CONTROL SYSTEM EVALUATION

Internal Control Components	Preliminary Conclusions/Actions Needed (see individual evaluation tools)	Additional Considerations
<p>Control Environment - Does management adequately convey the message that integrity cannot be compromised? Is an attitude of control consciousness throughout the organization, and a positive "tone at the top"? Is the competence of the entity's people commensurate with their responsibilities? Are management's operating style, the way it assigns authority and responsibility and organizes and develops its people appropriate? Does the board provide the right level of attention?</p>	<p>Management has demonstrated its commitment to integrity, ethical behavior and competence of the company's people, and has communicated that commitment to all employees. The company's control environment is conducive to effective internal control, and provides a positive influence that enhances the likelihood of achieving ABC's objectives.</p>	<p>The board and I (CEO) are considering the benefits of a formal code of conduct. I am monitoring the effectiveness of the recent organizational structure modifications, which resulted from the Laker Parts acquisition and divestiture of the defense division, and will introduce changes as appropriate. In addition, newly created key manager responsibilities will be evaluated over time and changed as needed. The Laker Parts acquisition has resulted also in a duplication of some accounting department functions. Reviews of personnel requirements are underway.</p>

Internal Control Components	Preliminary Conclusions/Actions Needed (see individual evaluation tools)	Additional Considerations
<p>Risk Assessment -- Are entity-wide objectives and supporting activity-level objectives established and linked? Are the internal and external risks that influence the success or failure of the achievement of the objectives identified and assessed? Are mechanisms in place to identify changes affecting the entity's ability to achieve its objectives? Are policies and procedures modified as needed?</p>	<p>The company-wide objectives and strategies provide relevant guidance on what the entity is to achieve and how it will be achieved. Resources are allocated to achieve objectives commensurate with their importance. Activity-level objectives have been developed to support achieving the company-wide objectives. Those activity-level objectives are consistent with and complement each other.</p> <p>ABC management identifies and assesses risk informally on an ongoing basis, and formally in conjunction with the annual update of the business plan. Appropriate actions are taken to manage the risks. Hedges for materials cost increases and modernizing production processes need to be addressed.</p> <p>Controls to identify and react to changes are adequate. We need to continue to watch for potential morale weakness from former Laker Parts employees. Consider having human resources monitor attitudes and performance.</p>	<p>The implications of competitive pressures for long-term growth and profitability objectives will continue to require the attention of operating and financial management. Such attention will be provided.</p> <p>The development of new or modified production processes will be expedited to keep pace with changes in the industry.</p> <p>Further consolidation of the commercial airline industry and government re-regulation of the industry are changes that could adversely affect the company. These changes are followed closely and strategies are being developed to respond to the changes.</p>

Internal Control Components

Preliminary Conclusions/Actions Needed
(see individual evaluation tools)

Additional Considerations

Control Activities -- Are control activities in place to ensure adherence to established policy and the carrying out of actions to address the related risks? Are there appropriate control activities for each of the entity's activities?

Control activities have been designed and implemented to address significant risks related to department and unit activity objectives. Concerns raised re materials testing and handling hazardous materials need to be addressed.

Activities for testing materials for determining whether to accept or reject shipments, and procedures for training operations personnel on OSHA requirements for disposal of hazardous waste, will be refined and formalized.

Information and Communication -- Are information systems in place to identify and capture pertinent information -- financial and nonfinancial, relating to external and internal events -- and bring it to personnel in a form that enables them to carry out their responsibilities? Does communication of relevant information take place? Is it clear with respect to expectations and responsibilities of individuals and groups, and reporting of results? And does communication occur down, across and upward in the entity, as well as between the entity and other parties?

Information systems provide management with the information needed, on a timely basis, to manage the company effectively. Generally, communication within the entity and with external parties is effective. The following items will be considered to enhance effective communication further: Develop a formal corporate code of conduct, and further encourage department managers to solicit and consider constructive suggestions from personnel at all levels.

Available information related to competitors' activities in the development of lighter weight materials for use in production, and exposures to foreign currency exchange losses from an unstable U.S. dollar will be obtained and considered in our long-term strategies.

A formal program to communicate the company's ethical standards to vendors and other outside parties will be developed.

Internal Control Components	Preliminary Conclusions/Actions Needed (see individual evaluation tools)	Additional Considerations
<p>Monitoring -- Are appropriate procedures in place to monitor on an ongoing basis, or to periodically evaluate the functioning of the other components of internal control? Are deficiencies reported to the right people? Are policies and procedures modified as needed?</p>	<p>Internal control monitoring is appropriate and sufficient. Although employee compliance with the behavioral expectations outlined in the employee manual is high, management will consider the benefit of formalizing a code of conduct and requiring periodic employee affirmation that they understand and comply with it. The internal audit function is new, and is expected to grow and become more effective over time. The scope of separate evaluations needs to be considered.</p>	<p>Ongoing monitoring of the former Laker Parts operation is important to assuring the continued effectiveness and overall consistency with the consolidated company. Factors of particular importance are the appropriateness of its organizational structure and assignment of responsibilities to key managers. I plan to continue to monitor these areas. I will instruct the head of internal audit to develop a formal evaluation process.</p>

OVERALL CONCLUSION

ABC's system of internal control, as of December 31, 19xx, is effective and provides reasonable assurance that the company's financial reporting process is reliable, that the company has effective procedures for ensuring compliance with applicable laws and regulations, and that management is aware of the extent to which the company is moving toward achieving the operations objectives.