Our previous segments have shared a wide variety of information about internal controls and the control environment. We have examined many of the challenges imbedded in establishing and maintaining a strong internal control framework. We’ve discussed various roles and responsibilities related to internal control actions and assessments. Each element is a very important attribute for allowing organizations to build and sustain pieces of internal control. But ultimately, within this segment we focused on where the real responsibility for internal controls may lie. That place is with management.

Shortly after the Sarbanes-Oxley act of 2002, the Office of Management Budget issued OMB Circular A-123 to address their position and policy on internal control. This circular sets a strong baseline for where companies should place focus on responsible parties towards internal controls.
The circular states the office policy as:
- Management is responsible for establishing and maintaining internal control to achieve the objectives of effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations.
- Management shall consistently apply the internal control standards to meet each of the internal control objectives and to assess internal control effectiveness.
- When assessing the effectiveness of internal control over financial reporting and compliance with financial-related laws and regulations, management must follow the OMB’s outlined assessment process.
- Annually, management must provide assurances on internal control in its Performance and Accountability Report, including a separate assurance on internal control over financial reporting, along with a report on identified material weaknesses and corrective actions.

Actions required by the circular indicate agencies and individual Federal managers must take systematic and proactive measures to
- Develop and implement appropriate, cost-effective internal control for results-oriented management;
- Assess the adequacy of internal control in Federal programs and operations;
- Separately assess and document internal control over financial reporting consistent with the process
- Identify needed improvements;
- Take corresponding corrective action; and
- Report annually on internal control through management assurance statements.

We can discuss and debate all of the various benefits and challenges of the internal control world. In today’s age, there is a much stronger focus and belief in the benefit category. However, there are still those individuals who have their doubts on the real purpose and benefit of internal controls. Admittedly, the many steps, checks and balances, validations and monitoring can result in slowing down the production process. However, as with all tasks, we must be able to judge the cost vs. benefit of each scenario.

Internal control concepts are not new. As we learned in several of our webinar segments, internal control goes back to early Egyptian times and the role of the tax collector. We use the concept of internal control in our daily personal lives to help manage and mitigate those various risks that may arise from having toddlers, teenagers, pets, cars, homes etc. A simple scenario might be the new parent who takes the precautions to cover outlets in the home and to lock cabinets so a toddler cannot inadvertently get into trouble. The parent is talking responsibility to manage their internal control environment. They have recognized the potential risk that has been placed in front of them and have chosen to take appropriately pre-cautions to keep their children safe. Even those precautions may cause a bit of inconvenience for them personally, the parents have recognized that they are important.

If only our corporate world was so straight forward. Managers often recognize that certain controls or checkpoints are important to their individual processes, but it is easy for them to rationalize cost vs. benefit elements and make decisions to “accept” some of the risks that may be placed in front of them because of outside pressures being placed on meeting individual goals. That acceptance, in some cases, is an appropriate management recognition and decision relating to risk vs. reward. In other cases, inability to imbed specific controls can be viewed as a significant control deficiency that can put the company at grave risk for meeting strategic objectives or exposing the company to fraudulent behavior.

So the question becomes, how do we decide when to accept or reject proposed internal controls? As we’ve discussed before, there is no textbook answer. But this is an area where management should proceed with great caution. Once you go down the slippery slope of accepting risk, it becomes easier to avoid controls and ultimately the snake may sneak out and bite you unexpectedly.

One of the most fundamental elements of internal control is the concept of segregation of duties. We have discussed this concept within other articles. It is also one of the most difficult concepts when we consider smaller organizations or times when resources are constrained. But ultimately, the concept is important because it not only protects the company but it protects the employee. Proper segregation of duties is a heavily focused on control for Sarbanes-Oxley purposes and also as a measure to prevent fraud. Whenever duties are not appropriately segregated, opportunity arises for issues to occur. We’ve learned from Sarbanes-Oxley that it is not acceptable to either claim ignorance of the process or to indicate that the control is not necessary because it is placing an undue burden on the organization. Controls are not meant to keep the organization from running or completing its objectives. However, controls are necessary to ensure the effective operation of the organization and to protect its resources. Until all managers understand that concept and fully embrace its intent, we will continue to struggle with the battle over perceived unnecessary controls or that periodic comment that “those mandates are preventing me from running my business!”
As with the topic of fraud, the best method to ensure controls are properly understood and focused on is through organizational awareness. Individuals must understand the importance of controls both from a check and balance viewpoint and also from an efficiency and effectiveness viewpoint. Few individuals will argue with controls that are often put in place for safety or environmental reasons. Often, those precautions have very evident benefits. Requiring the wearing of a hard hat in a construction site or prohibiting the entrance into hazard areas have very obvious benefits. It is a bit harder for management to see the benefits of reconciliation procedures, sign-offs, certifications, verification counts etc. But as we learned in so many of the past decades corporate failures, the avoidance of simple controls have often led to some of the most dramatic negative implications to a company. Take for example Wal-Mart’s refusal to heed the warnings of the independent evaluators related to the franchise issue in Mexico. Or what about BP Petroleum’s failure to recognize the warnings given by their engineers in the early stages of development of the fittings for the pipe that failed in the gulf. The failure to recognize these simple warnings or control procedures will have long-term effects on these companies.

And yes, some will write these examples off as “extraordinary.” But are they really? How often do companies “looks the other way,” or chose to “accept the risk” because they deem it to be too cumbersome on their process. These scenarios probably occur multiple times a day in every organization. Possibly, that is part of the difficulty in convincing management that internal controls are important. When individuals believe that something “bad” must happen or the existence of the control is not really a big deal, you will always be facing an uphill battle in establishing a culture of control awareness and accountability.

Organizations who proactively train their personnel on proper control procedures, whether those controls be related to financial, operational or compliance processes, are organizations that will ultimately provide their stakeholders with the highest level of assurance towards meeting overall company goals and objectives. It is great to have a goal that “safety is a top concern” and then to ensure all appropriate safety procedures are in place and being followed. But using that example, what happens in the event proper information technology controls are not in place and the incident allows an information breech that exposes company, personnel or shareholder information. In essence, this breech of information has put the “safety” of the company at risk. Shouldn’t this be a top concern along with the need to provide hard hats, security badges etc.?

The newest lingo in the corporate world today relates to phrases such as Enterprise Risk Management and Governance Risk and Compliance. Experts tout the benefits of these processes to organizations. Indeed, these initiatives can produce great benefits to organizations that pursue active evaluation. However, before entering into a detailed initiative related to ERM or GRC, organizations should ensure that they have adequately covered and evaluated the concepts of controls and accountabilities within their organization. These concepts are part of the very foundation of ERM and GRC and without appropriate attention; any effort towards a larger initiative may not utilize company resources in the most advantageous manner.

Ultimately, until all managers within an organization understand their roles related to internal controls and accept that their role is critical to the ongoing viability of the organization as well as the effective execution of their responsibilities; organizations will continue to struggle with the concepts of control environment, culture, internal controls and accountability. For many organizations, to accomplish this objective will require a culture shift and mindset change. However, the longer that shift and change are prolonged, the harder it will be to imbed in the organization. Inevitably, these factors will continue to contribute to control issues that permeate our businesses and everyday work life.

The next time you choose to skip a control procedure within your own job responsibilities, think to yourself...how would you feel if:

- Your doctor forgot to use sterilize the tools before a surgical procedures he was about to perform for you.
- The Ferris wheel operator decided to take a lunch break when your car was stopped at the top of the wheel.
- Your car mechanic forgot to tighten down the lug nuts on your tire after performing simple maintenance.

Sure, you may judge the severity of some of these things as different than some check and balance that you may perform in your job, but do you want each of the above individuals to utilize their own subjective judgment in deciding the severity of skipping by the control in their process?