
# Internal Controls Optimization

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*San Francisco Chapter*


# Background on Internal Controls

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Business advances that have offered growth and opportunity in the recent past have also delivered unforeseen consequences, specifically the areas of:

- increased inefficiency for most major businesses as a result of additional regulatory compliance requirements
- globalization trends have challenged businesses to maintain high levels of process efficiency and effectiveness
- renewed and increased pressure to identify cost savings

# Background on Internal Controls

Sarbanes-Oxley 404 projects have offered unprecedented insight into how businesses operate their internal control environments and where common opportunities lie for improvement in the financial reporting area.

Public and private companies across the world are now looking to exploit these control opportunities. This is achieved through actively pursuing a system of controls beyond the financial reporting risks of 404 to focus on operational, regulatory and other risks across the enterprise where major opportunities for improvement lie.


# What do we mean by Internal Controls and Controls Optimization

# Internal Control – what does this mean?

Internal control is broadly defined as a process that is:

- Effected by an entity's board of directors, management and other personnel
- Designed to provide reasonable assurance of intended objectives
- Measured in the following ways:
  - Effectiveness and efficiency of operations
  - Reliability of financial reporting
  - Compliance with applicable laws and regulations

# Controls Optimization – what does this mean?

A continuous process of improvement, reflecting a company's objectives and risks and the risk appetite of management by establishing effective and efficient internal controls at the right cost for the organization


# Drivers for “optimization”

# Drivers for Optimization

- Organizational changes
  - M&A / IPO
  - Centralization / Outsourcing
  - Systems implementation
  - Process redesign
- Costs and complexity
  - Multiple systems
  - Manual controls
  - Duplicated controls
  - Poor controls culture
- Reliability of information
  - Financial Information restatements
  - Control failures
  - Timeliness
  - Ineffective monitoring
- Governance and compliance
  - Board needs
  - Fraud risks
  - Accountability
  - Regulatory requirements
  - **AS5/SOx**

# Factors to Consider

- Controls over the risks (financial, strategic, operating and regulatory). Are they simple, transparent and cost effective?
- What are the necessary operating costs of systems, processes and controls?
- Appropriately containing the ongoing cost of regulatory compliance while minimizing the risk of non-compliance
- Flexible controls to enable business change and add real value to the organization


# How to get started on the path to "optimization"

Controls optimization defined

# Understanding the System of Controls


- Organizations should be able to evaluate their controls environment, through self assessment practices.
- Obtain attributes of key controls (number, manual vs. automated).
- Review the unique aspects of your business that may require more or less time spent on internal controls assessments
  - Decentralization,
  - Diversity of products and revenue streams,
  - Lack of standardization,
  - Previous challenges or financial restatements

# Understanding the System of Controls

- Has the organization made the clear linkage between risk and controls?
  - Effectiveness and efficiency of operations
  - Reliability of financial reporting (Relevant FS Assertion)
  - Compliance with applicable laws and regulations
- Are the current controls focused on risk or coverage?
- Define the desired “To Be” state of Internal Controls
  - Unreliable
  - Informal
  - Standardized
  - Monitored
  - Optimized


# Controls Optimization Methods

# Top-Down, Risk-Based Approach

Goal: To identify the “right” controls. It’s not about finding a specific number of controls, but identifying the controls that mitigate the key risks for the organization

- Internal key risks to the organization should be identified either from a financial, operational, or compliance perspective
- The current business environment and corporate strategy will drive the organizational direction and effect the specific risks encountered

Note: This is a dynamic and ongoing process that must be revisited frequently as business, market, and technology environments evolve

# Conducting the Risk Assessment

The organization should perform the following on the path to Controls Optimization:

- Define the measures for internal control effectiveness
- Determine the key risks
- Identify the list of processes
- Review previous control failures and strengths
- Assess pervasiveness and suitability of company level controls

# Rationalize Internal Controls

Aligning and prioritizing the ‘right’ controls to the identified risks:

- Entity Level Control
  - Strategic management and oversight
  - Direct versus indirect
  - Business Performance Reviews
- Transactional level controls
  - Manual versus Automated Controls
  - Preventative versus Detective
- Information Technology General Controls
  - Change Management
  - Security
  - Program Management
  - Operations

# Optimize Internal Controls

Perform optimization assessment, considering the following:

- Identify duplicate controls
- Assess pervasiveness and suitability of entity level controls
- Opportunities for further automation
  - Eliminating the human factor
- Reliance on spreadsheets and other desktop applications
- Appropriate Segregation of Duties
- Effectiveness of transaction level controls
  - Preventative versus detective
  - Utilization of monitoring controls

# Optimize Internal Controls

Example: Use of Entity Level Controls

- Small decentralized software company with 4 significant locations and 10 other locations recording revenue
- Informal FP&A process have historically missed significant adjustments
- Implemented formalized process to disaggregate and document budget to actual reviews at a low enough level to identify material errors

# Optimize Internal Controls

Example: Transitioning from manual to automated controls

- Mid-sized company
- Maintenance amortization has to date been adjusted from full-month convention to daily amortization through manual calculation
- Implemented new module in Oracle that automates the daily amortization calculation
- Replace prior spreadsheet control with embedded automated control

# Creating a Sustainable Organization

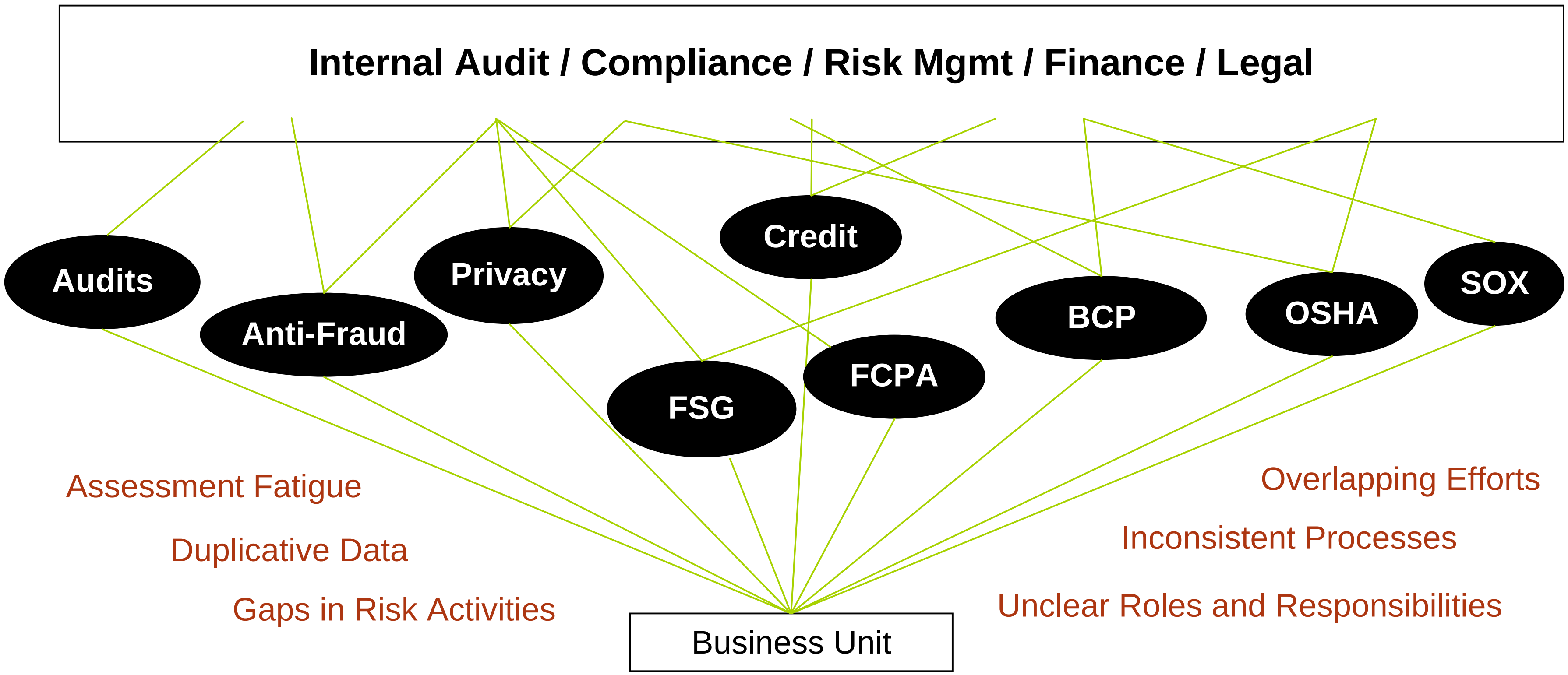
Creating sustainable infrastructure:

- Leadership and strategy (Leverage Corporate Values)
- Accountability and reinforcement
- Risk management and infrastructure
- People and communication
- Testing approach and plans
- Change management procedures

Building on the Value

- Leveraging Controls Optimization Investment
- Ensuring there is a measurable and sustainable compliance function

# Building on the value




- Identify relevant standards and regulatory requirements applicable across governance, risk and compliance requirements
- Opportunities for integration exist across silo operations that are performing similar activities.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# Questions?

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