

# Robust Internal Controls Matter

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Many companies in Singapore do not currently follow any specific internal control or risk management framework, and unlike countries like the United States, Japan and China, adoption of these frameworks is not mandatory. Frameworks provide companies with a solid foundation for improving performance and achieving strategic objectives by equipping them with tools and perspectives to facilitate and support the governance process. In light of this, the Guidebook for Audit Committees in Singapore (Second Edition) recommended the adoption of COSO Frameworks (The Committee of Sponsoring Organizations of the Treadway Commission or COSO) as the standard for effective internal controls and enterprise risk management.

COSO was formed in the United States in 1985 out of the need for improved organizational performance and governance through more effective internal controls, enterprise risk management and fraud deterrence. The COSO Frameworks were developed in 1992 and 2004, and comprise the Internal Control – Integrated Framework and the Enterprise Risk Management – Integrated Framework, respectively.

In May 2013, the Board of COSO released the updated Internal Control – Integrated Framework, which takes into consideration the evolving global business environment, the increased expectations for competencies and accountabilities across all levels of organizations, as well as the need to prevent and detect fraud. A similar update for the 2004 Enterprise Risk Management – Integrated Framework is currently underway to reflect the evolution of risk management thought and practice, and stakeholder expectations.

## Implementing COSO Frameworks

The COSO Frameworks are widely adopted by publicly-traded companies in the United States, Japan and China, corporate environments where strict rules have been introduced through the implementation of the Sarbanes-Oxley Act or similar legislation to cover internal control over financial reporting in order to improve the accuracy and reliability of corporate disclosures and considerations for the future.

However, not just for publicly-traded companies, there has been increasing acceptance of the COSO Frameworks as an international best practice by governments. In 2013, the Government of Indonesia adopted COSO as its control framework for all its ministries and local governments. More recently, the United States Government Accountability Office's updated Standards for Internal Control in the Federal Government (known as the 'Green Book') adapted COSO's five components of internal control principles for a government environment. Its guidelines can be adopted by state, local and quasi-government entities, as well as not-for-profit organizations.

The Protiviti-SAC COSO Academy was set up with the mission to raise awareness and promote the adoption of the COSO Frameworks among organizations in Singapore. From a recently conducted survey, it was found that while 94% of respondents were aware of the COSO Frameworks, only 56% had implemented either one or both of the frameworks, or were using another framework. Limited manpower, lack of training and perceived low value of the benefits of the COSO Frameworks, were among challenges cited for the less than ideal adoption rate.

Implementing the COSO Frameworks can help companies actively minimize incidences of fraud, better manage internal processes, and ultimately deliver peace-

of-mind to stakeholders. Building a strong control environment should be a priority because it lays the foundation for the organization to position itself to be more resilient in the face of internal and external pressures.

## 5 Steps to Building a Robust Internal Controls Framework

### 1 Set the tone at the top.

The COSO Framework emphasizes the importance of the tone at the top and the Board's responsibility for overseeing the development and performance of internal controls. While there is no doubt that the tone at the top is shaped primarily by the CEO's operating style and his or her team's personal conduct, it is also true that directors exercise significant influence over the organization's attitude toward risk, the aggressiveness of its policy choices and its commitment to responsible business behavior. These considerations send a message to the organization.

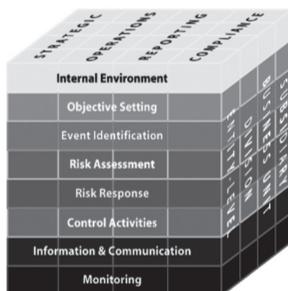
### 2 Define the control environment to ensure the organization acts with integrity.

The significance of the framework is that it defines the control environment over which directors have substantial influence. The Board demonstrates independence from management and exercises appropriate oversight; management establishes (with Board oversight) structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of objectives; the organization attracts, develops and retains competent people; and the organization holds people accountable for results.

COSO Internal Control Framework



COSO Risk Management Framework

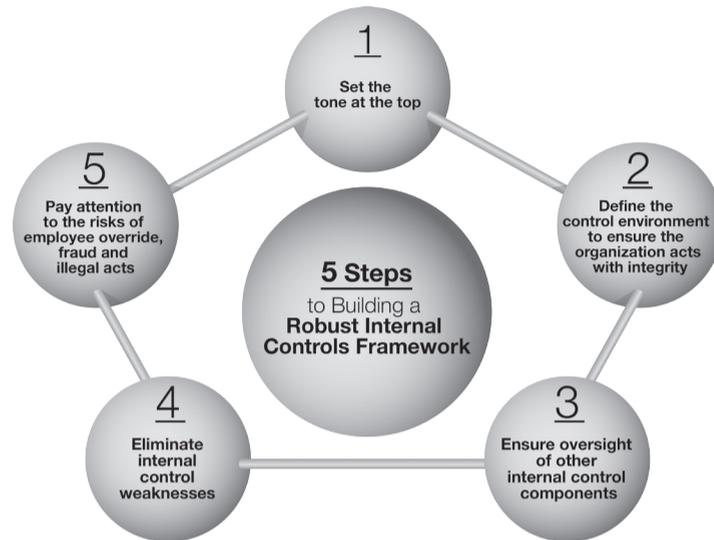


### 3 Ensure oversight of the other internal control components.

Board and management should consider internal and external factors that pose significant risk to the achievement of objectives. For example, the Board should evaluate and challenge assessment of risks inherent in new strategic initiatives, such as pursuing new markets or proposed acquisitions or innovating facilities and processes, and check the effectiveness of the design and operation of control activities in reducing risk to an acceptable level in critical areas.

### 4 Eliminate internal control weaknesses.

Minimize unwanted incidents such as fraud or other financial scandals that result in a reputation hit arising from weak internal control systems. Besides financial reporting controls, when controls over operations and compliance are effectively designed, these add value in terms of



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ensuring strong quality, time, cost and innovation performance.

authorization, execution and asset custody are divided among different employees.

### 5 Pay attention to the risks of employee override, fraud and illegal acts.

The Board is the last line of defense on matters involving management overriding established controls for an illegitimate purpose, including personal gain or “cooking the books.” The COSO Framework states that management should assess risk in areas susceptible to fraud and illegal acts and improve controls in those areas, and the Board should provide input on such assessments.

### Minimizing Fraud

The COSO Framework depicts the interrelationship among an organization's objectives, the components of internal control, and the operating units, legal entities and other structures within the entity and indicates the importance of management's judgment in evaluating the effectiveness of a system of internal control. Determination of effectiveness is a subjective judgment resulting from assessment of whether (1) each of the five components of internal control (as reflected in the COSO Framework) is present and functioning and (2) the five components operate together to provide “reasonable assurance” that the relevant objectives are met.

The Framework facilitates this exercise of judgment by providing a total of 17 principles for the five components, upon which management exercises judgment to determine the extent to which they are present and functioning in evaluating whether the components to which these principles relate are present and functioning.

One of the risks to reliable financial reporting is the issue of management fraud, which can arise as a result of management override of internal controls. The five principles underlying the Control Environment component facilitate the tone at the top that provides checks and balances in dealing with this issue. The COSO Framework states that if management is able to override controls, the entire system may fail.

Another factor is segregation of duties, which can address important risks relating to management override. Segregation of duties is fundamental to mitigating fraud risks because it reduces the risk of a single person acting alone. However, there is always the risk that management can override control activities. Collusion is needed to perform fraudulent activities when key process responsibilities around

### Bridging the Knowledge Gaps

Respondents of the awareness survey conducted by the Protiviti-SAC COSO Academy highlighted the need for training and a forum to share and learn from best practice as factors that could help improve adoption rates among Singapore organizations.

At workshops conducted by experienced senior risk and control practitioners, the Protiviti-SAC COSO Academy seeks to build a better understanding of the COSO Frameworks and show how these can be integrated into an organization's existing risk and control systems to strengthen internal processes and comply with governance and business requirements.

The programme is specially developed for (1) Board members, Chief Executive Officers and Chief Financial Officers, and for (2) Heads of Internal Audit, Heads of Risk Management, Internal Audit personnel, Risk Management personnel. As

### Principle 8 in the COSO Framework relates to fraud:

The organization considers the potential for fraud in assessing risks to the achievement of objectives.

each session is customized for its audience, participants are able to gain valuable insights and practical tips which would be useful to them. The workshops are forums for interactive discussions and the sharing of best practice by participants from organizations across industries.

First-of-its-kind in the world, the Protiviti-SAC COSO Academy is supported by The Committee of Sponsoring Organizations of the Treadway Commission ([www.coso.org](http://www.coso.org)). With the Singapore Accountancy Commission and strategic partners, the Institute of Internal Auditors Singapore, Singapore Management University's School of Accountancy and the Securities Investors Association (Singapore) or SIAS, Protiviti is proud to share its extensive international experience in the COSO Frameworks with the business community in Singapore.

*This article has been adapted from various thought leadership commentaries by Protiviti. Sidney Lim, Managing Director of Protiviti Southeast Asia, and Uantchern Loh, Chief Executive of Singapore Accountancy Commission, are founders of the Protiviti-SAC COSO Academy in Singapore.*

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