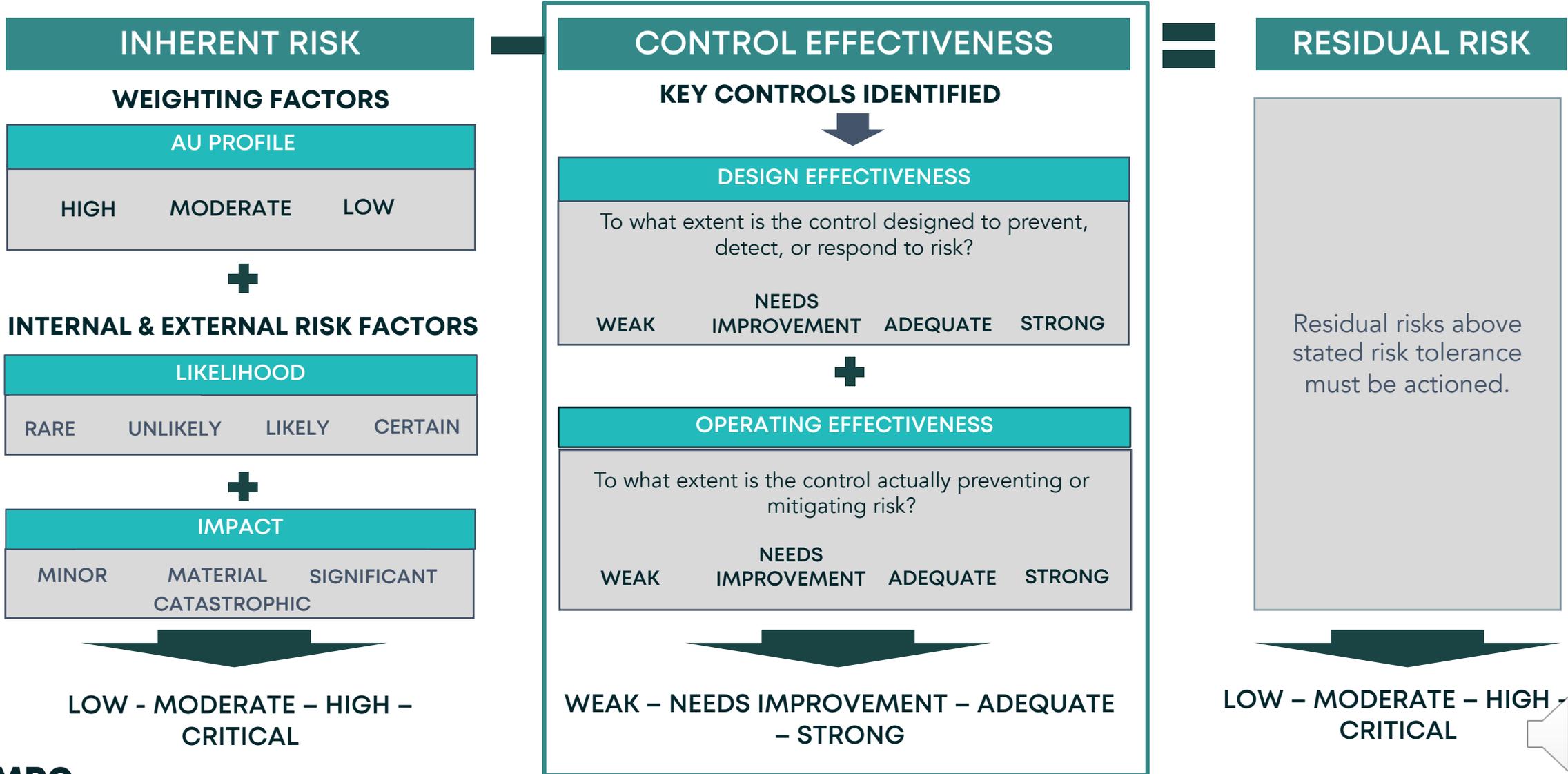


# 03

## ASSESSING INTERNAL CONTROL EFFECTIVENESS



# Illustrative example of a risk assessment formula



## ASSESSING INTERNAL CONTROL EFFECTIVENESS

# Focus on Key Controls

Although there is not a single definition of a Key Control in industry, it is beneficial to define what a Key Control is in order to save time on documentation, assessment, and enable stakeholders to focus on what matters.

The following graphic provides guidance on how to distinguish between Key and Non-Key Controls:

### Characteristics of a Key Control

It is indispensable to meet the control objective - if it fails, it is unlikely that other controls could prevent or detect the issue

It has a direct impact on the risk profile

It has a direct impact on the ability to achieve strategic business objectives

It is mandatory (i.e., prescriptively required by law or regulation)

VS

### Characteristics of a Non-Key Control

If the control fails, it is unlikely to impact the ability to achieve the control objective

It has an indirect or no impact on the risk profile

If the control fails, it will at most have an indirect impact on the ability to achieve strategic business objectives

It is not required or expected to be in place by a regulator and/or is in place to optimize/enhance performance

### Rules of Thumb

- If it is a preventative control, it is likely a Key Control
- If it is an entity-level control, it is likely a Key Control
- If it is a central control, it is likely a Key Control

### Rules of Thumb

- If it is rarely or never included in Internal or External Audit testing, it is likely a Non-Key Control
- If the control is operating below an L2 process-level, it is likely a Non-Key Control

# Illustrative example of methodology used to assess internal control design effectiveness

When assessing the design of each Key Control, use the following methodology to determine the design effectiveness score:

		Control Type			Control Method			Control Coverage		Frequency			Lag Time		Certainty	
OPTIONS	PREVENTATIVE	DIRECTIVE	DETECTIVE	FULLY AUTOMATED	PARTIALLY AUTOMATED	MANUAL	100%	<100%	CONTINUOUS	PERIODIC & SCHEDULED	AD HOC	NONE or N/A	> None	DEFINITIVE	REQUIRES JUDGEMENT	
	SCORE	1	0.5	0.25	1	0.75	0.5	1	0.5	0.5	0.25	0	0.25	0	0.25	0

+

### Control Documentation Score

Fully Documented	0
Not Documented	-1

Control Documentation Score (-1 to 0)	=	Total Design Score (0-4)
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### Design Effectiveness Rating Scale

- 4 = Strong
- 2.25 to <4 = Adequate
- 1.5 to <2.25 = Needs Improvement
- 0 to <1.5 = Weak

Overall Design Effectiveness Rating



ASSESSING INTERNAL CONTROL EFFECTIVENESS

# Illustrative example of control design effectiveness assessment

Key Control examples	Description	Control Characteristics						CONTROL DOCUMENTATION SCORE	Design Score	
		Control Type	Method	Coverage	Frequency	Lag Time	Certainty			
System-enforced	Controls which prevent breaches without the need for human intervention	Preventative 1	Fully Automated 1	100% 1	Continuous 0.5	N/A 0.25	Definitive 0.25	0	4	STRONG
Pre-approval	Secondary approval is required to proceed with an action (no exceptions)	Preventative 1	Manual 0.5	100% 1	Continuous 0.5	N/A 0.25	Definitive 0.25	0	3.5	ADEQUATE
Prescribed process	Activities which follow a prescribed process enabled by pre-defined forms, templates, checklists, or workflows (no exceptions without escalation)	Preventative 1	Manual 0.5	100% 1	Continuous 0.5	N/A 0.25	Definitive 0.25	0	3.5	ADEQUATE
Escalation	Escalation to a supervisor or subject matter expert is required to proceed with an action when outside the employee's authority or competency	Preventative 1	Manual 0.5	< 100% 0.5	Ad Hoc 0	N/A 0.25	Requires judgement 0	-1	1.25	WEAK
Procedures	Step-by-step instructions directing the specific sequence of actions to be followed in order to accomplish a particular objective	Directive 0.5	Manual 0.5	< 100% 0.5	Continuous 0.5	N/A 0.25	Requires judgement 0	0	2.25	ADEQUATE
Training	Formal imparting of knowledge, skills, competencies to enhance understanding and ability to perform specific tasks, roles, or functions	Directive 0.5	Manual 0.5	<100% 0.5	Periodic 0.25	N/A 0.25	Requires judgement 0	0	2.0	NEEDS IMPROVEMENT
Exception monitoring	Automated detection of any breach or anomaly	Detective 0.25	Partially Automated 0.75	100% 1	Continuous 0.5	One week 0	Definitive 0.25	0	2.75	ADEQUATE
Reconciliation	Comparing and verifying two sets of records, accounts, or data to ensure their accuracy, consistency, and alignment	Detective 0.25	Manual 0.5	100% 1	Continuous 0.5	One month 0	Definitive 0.25	-1	2.0	NEEDS IMPROVEMENT
Data monitoring	Use of reports or other data monitoring mechanisms to identify patterns, trends, issues, change in control effectiveness	Detective 0.25	Partially Automated 0.75	< 100% 0.5	Periodic 0.25	One month 0	Requires judgement 0	0	1.75	NEEDS IMPROVEMENT
Post-booking review	Periodic review of a sample of activities to identify potential issues	Detective 0.25	Manual 0.5	< 100% 0.5	Periodic 0.25	One month 0	Requires judgement 0	0	1.5	NEEDS IMPROVEMENT
Data analysis	Targeted analysis of data to identify potential issues	Detective 0.25	Manual 0.5	< 100% 0.5	Ad Hoc 0	One month 0	Requires judgement 0	-1	0.25	WEAK
Field Testing	Ad hoc review of a sample of activities to identify potential issues	Detective 0.25	Manual 0.5	< 100% 0.5	Ad Hoc 0	> 1 month 0	Requires judgement 0	-1	0.25	WEAK



# Illustrative example of methodology used to assess internal control operating effectiveness

CONTROL TESTING SCORE	
CRITERIA	SCORE
Control has been tested within the last 6 months	2
Control was last tested >6 months but <1 year ago	1
Control was last tested more than 1 year ago	0.5
Control has not been tested	0

The control is considered tested as long as it has been tested by 2nd Line of Defence, 3rd Line of Defence, or by another sufficiently independent third-party (this does NOT include regulators).

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CONTROL ISSUES SCORE	
CRITERIA	SCORE*
No issues identified	2
Low and/or Medium severity issue(s) but none are recurring	1
High severity issue(s) or recurring issue(s) identified	0

\* If Issues Management has not been fully rolled out in the AU and/or Testing has not been performed in the last 12 months, the maximum Control Issue Score that can be assigned is 1.

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TOTAL SCORE

0-4

CONTROL OPERATING EFFECTIVENESS SCALE		
SCORE		RATING
	4	STRONG
2.25	<4	ADEQUATE
1.5	<2.25	NEEDS IMPROVEMENT
0	<1.5	WEAK

As with much of risk management, judgement is required to assign the ratings and conclusions must be supported with proper rationale.



# There are many sources of data that should be considered when assessing control operating effectiveness

The following are key sources of data that should be considered when assessing a control’s operating effectiveness:

SOURCE OF DATA	KEY CONSIDERATIONS
<b>MOST RECENT TESTING RESULTS</b>	<ul style="list-style-type: none"> <li><input type="checkbox"/> Has testing been performed since the last RCSA?</li> <li><input type="checkbox"/> Were any control deficiencies noted?</li> <li><input type="checkbox"/> If yes, what was the severity of the issues?</li> <li><input type="checkbox"/> If yes, have the issues been formally closed?</li> <li><input type="checkbox"/> What was the overall control rating (i.e., Satisfactory, NI, Unsatisfactory)?</li> </ul>
<b>INTERNAL AUDIT ISSUES</b>	<ul style="list-style-type: none"> <li><input type="checkbox"/> Has there been any IA reviews since the last RCSA?</li> <li><input type="checkbox"/> Were any control issues noted?</li> <li><input type="checkbox"/> If yes, what was the severity of the issues?</li> <li><input type="checkbox"/> If yes, have the issues been formally closed?</li> <li><input type="checkbox"/> What was the overall control rating (i.e., Satisfactory, NI, Unsatisfactory)?</li> </ul>
<b>THIRD-PARTY FINDINGS</b>	<ul style="list-style-type: none"> <li><input type="checkbox"/> Has there been any independent third-party reviews since the last RCSA?</li> </ul>
<b>REGULATORY FINDINGS</b>	<ul style="list-style-type: none"> <li><input type="checkbox"/> Has there been any regulatory reviews/examinations/monitoring performed since the last RCSA?</li> <li><input type="checkbox"/> Were any issues noted?</li> <li><input type="checkbox"/> If yes, what was the severity of the issues?</li> <li><input type="checkbox"/> If yes, have the issues been formally closed?</li> </ul>
<b>SIGNIFICANT EXTERNAL EVENTS</b>	<ul style="list-style-type: none"> <li><input type="checkbox"/> Have there been any relevant significant external events noted since the last RCSA?</li> <li><input type="checkbox"/> If yes, what lessons can we apply to the assessment of the firm’s relevant key controls (e.g., how might the incident happen to us)?</li> <li><input type="checkbox"/> Has there been any notable change in ORM trends in industry?</li> </ul>

# Overall control effectiveness is determined by combining design and operating effectiveness scores

The following is an illustrative example of methodology used to determine Overall Control Effectiveness Ratings:



OVERALL CONTROL EFFECTIVENESS		
SCORE RANGE	RATING	DRIVERS OF RATINGS
8	Strong	<ul style="list-style-type: none"> <li>Control is automated, preventative, and forward-looking</li> <li>Control is fully documented</li> <li>Control testing provides assurance that control is performing effectively as designed</li> <li>No issues identified</li> </ul>
4.5 - <8	Adequate	<ul style="list-style-type: none"> <li>Control is manual or hybrid and detective</li> <li>Control is fully documented</li> <li>Control testing provides assurance that the control is performing as intended</li> <li>No material issues identified</li> </ul>
3 - <4.5	Needs Improvement	<ul style="list-style-type: none"> <li>Control is manual or ad hoc</li> <li>Control is only partially documented</li> <li>Control testing has not been performed or has identified medium severity issues</li> </ul>
0 - <3	Weak	<ul style="list-style-type: none"> <li>Control is manual and ad hoc</li> <li>Control is not documented</li> <li>Testing may or may not have been performed</li> <li>Material issues identified</li> </ul>



# End of Week 3 videos

