



Asset Leadership Network

Management Systems Standards Work Within an Internal Control Framework

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What is an internal control framework? What does it do, and who does it apply to?

- Internal control is a process used by management and others to help an entity achieve its objectives
- Internal control helps an entity to: Run its operations efficiently and effectively, report reliable information about its operations and comply with applicable laws, regulations, standards, contracts and more

Is an internal control framework identified in law and who is required to use it?

- Yes. For U.S. Government Section 3512 (c) and (d) of Title 31 of the United States Code (commonly known as the *Federal Managers' Financial Integrity Act (FMFIA) of 1982* requires the Comptroller General to issue standards for internal control in the federal government. *Standards for Internal Control in the Federal Government (known as the GAO Green Book)* provide the overall framework for establishing and maintaining an effective internal control system. Office of Management and Budget (OMB) *Circular No. A-123* provides specific requirements for assessing and reporting on controls in the Federal government.
- For states and municipalities and others who receive Federal Grants are required *under 2 CFR 200 UNIFORM ADMINISTRATIVE REQUIREMENTS, COST PRINCIPLES, AND AUDIT REQUIREMENTS FOR FEDERAL AWARDS to use the GAO Green Book.*
- For publicly traded corporations:
 - Use of internal controls for reporting financials and asset accountability has been required since the Securities and Exchange Act of 1934. (15 U.S. Code § 78m - Periodical and other reports (b)(2), (4) and (5))
 - Sarbanes Oxley Act of 2002 Section 404 (15 U.S. Code § 7262 - Management assessment of internal controls) Strengthened management's responsibilities of internal controls.
 - The Public Company Accounting Oversight Board *Auditing Standard No. 5. An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements.* (2007) Requires audit organizations to identify the internal control framework used in the performance and reporting of an audit.
- What is the primary internal control framework used in the United States for Government and Public companies?
 - Committee of Sponsoring Organizations of the Treadway Commission (known as the COSO) Internal Control – Integrated Framework – May 2013. This requires internal control over reliable financial reporting, but also integrates with requirements of effective and efficient operations, non-financial reporting and compliance with laws, regulations and standards.
 - *Integrated reporting objectives – “These pertain to internal and external financial and non-financial reporting and may encompass reliability, timeliness, transparency, or other terms as set forth by recognized standard setters or the entity's policies.”*
 - *Internal control is not a serial process but a dynamic and integrated process.*

Standards are used within an internal control framework

What are management system standards, what do they do, how do they apply and to who?

Management system standards are written and vetted by recognized volunteer experts and published by consensus standards bodies that help organizations improve their performance by specifying repeatable steps that organizations consciously implement to achieve their goals and objectives, and to create an organizational culture that reflexively engages in a continuous cycle of self-evaluation, correction and improvement of operations and processes through heightened employee awareness and management leadership and commitment. For example ASTM E 2279 ... Guiding Principles ..., ISO 55000 Asset Management and ISO 9000 Quality Management are Management Systems Standards.

They apply to whatever organization of which they are applicable to, which may be established by reference in laws, case law, regulations, contracts and standards. They also may be applicable by assumption in laws, regulations, contracts and standards and they may be applicable by management's or director's decisions as placed in policy. In some organization standards are assumed to apply unless the organization opts out with a justifiable reason. Not adopting a standard can be as bad as not conforming to a standard. Some laws or regulations may be referred to as standards but are regulations, e.g. . 49 CFR Part 192 - TRANSPORTATION OF NATURAL AND OTHER GAS BY PIPELINE: MINIMUM FEDERAL SAFETY STANDARDS. Violating these safety standards in some cases can be deemed criminal. Some law may require organizations to have systems at least in conformity with standards practiced by industry.

Are management systems standards required to be used by an act of Congress? Yes.

The United States after becoming a member of the World Trade Organization and a signatory of the Uruguay Round Agreement on Technical Barriers to Trade. Congress, then enacted the National Technology Transfer and Advancement Act of 1995, PUBLIC LAW 104-113

The Congress finds the following: *(1) Bringing technology and industrial innovation to the marketplace is central to the economic, environmental, and social well-being of the people of the United States.*

*(d) UTILIZATION OF CONSENSUS TECHNICAL STANDARDS BY FEDERAL AGENCIES; REPORTS - (1) IN GENERAL- Except as provided in paragraph (3) of this subsection, all **Federal agencies and departments shall use technical standards that are developed or adopted by voluntary consensus standards bodies**, using such technical standards as a means to carry out policy objectives or activities determined by the agencies and departments. (The use is not voluntary.)*

OMB A119 Federal Participation in the Development and Use of Voluntary Consensus Standards and in Conformity Assessment Activities

*"This Circular **directs agencies to use standards developed or adopted by voluntary consensus standards bodies rather than government-unique standards**, except where inconsistent with applicable law or otherwise impractical."*

"Voluntary consensus standard" is a type of standard developed or adopted by voluntary consensus standards bodies"

Annex B provides Recommendations for Top Management and Directors of Organizations



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Annex A

(COSO) Internal Control-Integrated Framework-- Executive Summary Use of Standards Are an Element of Internal Controls

The Framework has been enhanced by expanding the financial reporting category of objectives to include other important forms of reporting, such as non-financial and internal reporting. Also, the *Framework* reflects considerations of many changes in the business and operating environments over the past several decades, including: --Demands and complexities in laws, rules, regulations, and **standards**.

Reporting Objectives-These pertain to internal and external financial and non-financial reporting and may encompass reliability, timeliness, transparency, or other terms as set forth by regulators, **recognized standard setters**, or the entity's policies.

Control Environment - The **control environment is the set of standards**, processes, and structures that provide the basis for carrying out internal control across the organization. The board of directors and senior management establish the **tone at the top** regarding the importance of internal control including **expected standards of conduct**.

Monitoring Activities -- Findings are evaluated against criteria established by regulators, **recognized standard-setting bodies** or management and the board of directors, and deficiencies are communicated to management and the board of directors as appropriate.

Effective Internal Control -- When a system of internal control is determined to be effective, senior management and the board of directors have reasonable assurance, relative to the application within the entity structure, that the organization: Complies with applicable laws, rules, regulations, and **external standards**.

The Framework requires judgment in designing, implementing, and conducting internal control and assessing its effectiveness. The use of judgment, within the boundaries established by laws, rules, regulations, and **standards**, **enhances management's ability to make better decisions about internal control**, but cannot guarantee perfect outcomes.



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Annex B

Recommended Actions and Improvements by Top Management and Directors

- Use the integrated internal controls and applicable standards as the path to success
- Embrace the seventeen principles internal control in the COSO / GAO Green Book
- Effectiveness of internal controls starts with the tone at the top
- Identify and empower a Chief Internal Control Officer to implement and oversee the system
- Recognized standards enhance and operate within an internal control framework
- Those who must comply, are not empowered to opt out of an applicable standard
- Beware of conflicts of interest in the adoption implementation of controls and standards
- Emphasize – standards apply unless the do not – and require a written justification
- Recognize Standards can protect, but can become threats with non-conformance
- Change the approach if standards do not improve operations and internal controls
- Recognize use can mean in whole or in part
- Management system standards may have elements in common but are not interchangeable, e.g. ISO 9000 Quality Management must not be used in lieu of ISO 55000 Asset Management
- Standards must not conflict with the internal control framework
- Start monitoring internal controls and standards with an initial baseline exercise
- Criminal and civil liability can exist if a person knowingly circumvents or knowingly fails to implement a system of internal controls

18 U.S.C. § 2510(6) to mean any individual person as well as natural and legal entities.



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https://www.wto.org/english/docs_e/legal_e/17-tbt_e.htm

- National Technology Transfer and Advancement Act of 1995 PUBLIC LAW 104-113
<https://www.nist.gov/standardsgov/national-technology-transfer-and-advancement-act-1995>
- OMB Circular A-119: Federal Participation in the Development and Use of Voluntary Consensus Standards and in Conformity Assessment Activities https://www.nist.gov/system/files/revise/circular_a-119_as_of_01-22-2016.pdf
- 18 U.S.C. § 2510(6) to mean any individual person as well as natural and legal entities.
<https://www.law.cornell.edu/uscode/text/18/2510>