

# Internal Controls Paradigm Shift

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## Introduction

The ERO Compliance Monitoring program is an integral process to ensure the reliability and resiliency of the Bulk Electric System. Over the course of time, the monitoring program has matured and shifted from being a compliance based plan to a process that is risk based and incorporates internal controls. Through the use and review of internal controls, an organization can protect its assets, ensure accurate reporting of data and compliance with the policies of the ERO, Region and the entity, and evaluate its performance. The following is part one of a two part series on internal controls.

## Elements of Internal Controls

Effective internal controls provide reasonable assurance regarding the accomplishment of the established objective. Internal control programs are generally comprised of the five components detailed below. Each component is important in its own right, and all components should be constantly evolving.

### 1. Control Environment

The control environment is the foundation of the internal control program. The control environment is how the organization addresses various aspects of company activities that include, but are not limited to, leadership philosophy, ethical values, policies, procedures and how management empowers their employees. The control environment embodies how the organization as a whole, from the CEO to the new employee, perceives, approaches and embraces the internal control program. Examples of the control environment include: company policies and procedures, anonymous hot lines, and vertical communication practices.

### 2. Risk Assessment

Assessing risk is a critical component of an internal control program. An organization must first establish their company objectives in order to determine the risks that would preclude the organization from achieving those objectives. Then the organization can move towards identifying the risks that could cause harm to the organization. This is not always an easy process. The organization must ensure it performs a risk analysis for both internal and external sources. The groundwork for an entity's risk assessment should include the risks associated with its registered function and the risk the entity poses to the BES. Because change is inevitable due to economics, regulatory and operating conditions, the organization must ensure it has implemented mechanisms capable of dealing with the risks associated with change.

The process of identifying and analyzing risk is an ongoing process. A constant assessment of an organization's risks should be performed in order to identify the impact the changing risk has on established internal controls. By consistently reviewing external and internal risks, an organization positions itself with the appropriate mechanisms needed to react timely to changing conditions.

### 3. Control Activities

Control activities, or internal controls, are the activities an organization performs to

ensure its established objectives are achieved. They are the mitigating actions an organization takes to address identified risks.

There are two types of control activities, key and non-key. Key control activities are those activities that if they are not performed, or performed incorrectly, will result in a process failing or providing inaccurate data. Non-key controls are secondary activities that, should they fail, will not affect the process. Examples of internal controls include activities as diverse as reviews, change management, incident documentation, authorizations, verifications, security of assets and segregation of duties, to name a few.

### 4. Information and Communication

Organizations require accurate, timely, pertinent information in a form and time frame that enables people to carry out their responsibilities. Effective communication flows down, across and up an organization. In order for internal controls to be embraced and taken seriously, the message must be provided in a clear, consistent manner from all levels of management. All employees must understand their role in the internal control program, as well as the importance their individual activities play as they relate to the work of others. Finally, it is imperative that employees are provided a means of communicating significant information upstream.

### 5. Monitoring

Internal control programs can only be effective if they are monitored. The breadth of the risk that the control is designed to mitigate will determine the scope and frequency of evaluation. Monitoring must be appropriately performed in order to ensure that the control continues to be effective and produce expected results. The assessment of all key controls performance over time, either in a formal or informal manner, must be performed in order to ensure that the control is performing as designed and producing expected results. Monitoring can occur in a variety of ways, either during the ordinary course of operations, it can be an established, defined process that includes management and supervisory activities. The monitoring process should start with establishing a baseline to determine normal performance, identifying the appropriate data to be collected, determining thresholds that initiate an alert, analyzing data to provide actionable insight and finally accurately reporting to all appropriate stakeholders.

Organizational risk changes over time, therefore so must internal control programs. The introduction of new technology, personnel, and regulatory demands can dilute once effective controls. Monitoring internal control programs aid in identifying those issues.