INTERNAL CONTROL FRAMEWORK

Introduction

Internal control helps entities achieve important objectives and sustain and improve performance. CLR's Internal Control Framework enables the organization to effectively and efficiently develop systems of internal control that adapt to changing operating environments, mitigate risks to acceptable levels, and support sound decision making and governance of the organization.

For ***management and steering board***, this Framework provides:

 • A means to apply internal control to any type of entity, regardless of industry or legal structure, at the levels of entity, operating unit, or function

 • A principles-based approach that provides flexibility and allows for judgment in designing, implementing, and conducting internal control—principles that can be applied at the entity, operating, and functional levels

 • Requirements for an effective system of internal control by considering how components and principles are present and functioning and how components operate together

 • A means to identify and analyze risks, and to develop and manage appropriate responses to risks within acceptable levels and with a greater focus on anti-fraud measures

• An opportunity to expand the application of internal control beyond financial reporting to other forms of reporting, operations, and compliance objectives

 • An opportunity to eliminate ineffective, redundant, or inefficient controls that provide minimal value in reducing risks to the achievement of the entity's objectives

For ***external stakeholders*** of an entity and others that interact with the entity, application of this Framework provides:

 • Greater confidence in the boards' oversight of internal control systems

 • Greater confidence regarding the achievement of entity objectives

 • Greater confidence in the organization's ability to identify, analyze, and respond to risk and changes in the business and operating environments

 • Greater understanding of the requirement of an effective system of internal control

 • Greater understanding that through the use of judgment, management may be able to eliminate ineffective, redundant, or inefficient controls

Internal control is not a serial process but a dynamic and integrated process. For the Centre for Labour Rights, as a smaller entity, the system of internal control is less formal and less structured, yet still executes effective internal control.

Defining Internal Control

Internal control is defined as follows:

Internal control is a process, effected by an entity's steering board, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance.

This definition reflects certain fundamental concepts. Internal control is:

 • Geared to the achievement of objectives in one or more categories—operations, reporting, and compliance

 • A process consisting of ongoing tasks and activities—a means to an end, not an end in itself

 • Effected by people—not merely about policy and procedure manuals, systems, and forms, but about people and the actions they take at every level of an organization to affect internal control

 • Able to provide reasonable assurance—but not absolute assurance, to an entity's senior management and board of directors

 • Adaptable to the entity structure—flexible in application for the entire entity or for a particular subsidiary, division, operating unit, or business process

Objectives

The Framework provides for three categories of objectives, which allow organizations to focus on differing aspects of internal control:

 • **Operations Objectives**—These pertain to effectiveness and efficiency of the entity's operations, including operational and financial performance goals, and safeguarding assets against loss.

 • **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.

 • **Compliance Objectives**—These pertain to adherence to laws and regulations to which the entity is subject.

The Centre for Labour Rights, exercises Internal Control through five integrated components as explained below:

Control Environment

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The control environment is the set of standards, processes, and structures that provide the basis for carrying out internal control across the organization. The steering board and senior management establish the tone at the top regarding the importance of internal control including expected standards of conduct. Management reinforces expectations at the various levels of the organization. The control environment comprises the integrity and ethical values of the organization; the parameters enabling the board of directors to carry out its governance oversight responsibilities; the organizational structure and assignment of authority and responsibility; the process for attracting, developing, and retaining competent individuals; and the rigor around performance measures, incentives, and rewards to drive accountability for performance. The resulting control environment has a pervasive impact on the overall system of internal control.

Risk Assessment

Every entity faces a variety of risks from external and internal sources. Risk is defined as the possibility that an event will occur and adversely affect the achievement of objectives. Risk assessment forms the basis for determining how risks will be managed.

A precondition to risk assessment is the establishment of objectives, linked at different levels of the entity. Management specifies objectives within categories relating to operations, reporting, and compliance with sufficient clarity to be able to identify and analyze risks to those objectives. Management also considers the suitability of the objectives for the entity. Risk assessment also requires management to consider the impact of possible changes in the external environment and within its own business model that may render internal control ineffective.

Control Activities

Control activities are the actions established through policies and procedures that help ensure that management's directives to mitigate risks to the achievement of objectives are carried out. Control activities are performed at all levels of the entity, at various stages, and over the technology environment. They may be preventive or detective in nature and may encompass a range of manual and automated activities such as authorizations and approvals, verifications, reconciliations, and business performance reviews.

Information and Communication

Information is necessary for the entity to carry out internal control responsibilities to support the achievement of its objectives. Management obtains or generates and uses relevant and quality information from both internal and external sources to support the functioning of other components of internal control. Communication is the continual, iterative process of providing, sharing, and obtaining necessary information. Internal communication is the means by which information is disseminated throughout the organization, flowing up, down, and across the entity. It enables personnel to receive a clear message from senior management that control responsibilities must be taken seriously.

Monitoring Activities

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Ongoing evaluations, separate evaluations, or some combination of the two are used to ascertain whether each of the five components of internal control, including controls to effect the principles within each component, is present and functioning. Ongoing evaluations, built into business processes at different levels of the entity, provide timely information. Separate evaluations, conducted periodically, will vary in scope and frequency depending on assessment of risks, effectiveness of ongoing evaluations, and other management considerations. 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.

The *Centre for Labour Rights* executes this Internal Control Framework consisting of five components explained above through its Manuals and Guidelines, which contain the work procedures of the organizations and the practical executions of each component by the responsible parties. Below, in bullet points, is explained the concrete work done by the organization in terms of the five components to assure an effective internal control.

Control Environment

1. The organization demonstrates a commitment to integrity and ethical values.

2. The board of directors demonstrates independence from management and exercises oversight of the development and performance of internal control.

3. Management establishes, with board oversight, structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of objectives.

4. The organization demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.

5. The organization holds individuals accountable for their internal control responsibilities in the pursuit of objectives.

Risk Assessment

6. The organization specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives.

7. The organization identifies risks to the achievement of its objectives across the entity and analyzes risks as a basis for determining how the risks should be managed.

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

9. The organization identifies and assesses changes that could significantly impact the system of internal control.

Control Activities

10. The organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.

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11. The organization selects and develops general control activities over technology to support the achievement of objectives.

12. The organization deploys control activities through policies that establish what is expected and procedures that put policies into action.

Information and Communication

13. The organization obtains or generates and uses relevant, quality information to support the functioning of internal control.

14. The organization internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of internal control.

15. The organization communicates with external parties regarding matters affecting the functioning of internal control.

Monitoring Activities

16. The organization selects, develops, and performs ongoing and/or separate evaluations to ascertain whether the components of internal control are present and functioning.

17. The organization evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action, including senior management and the board of directors, as appropriate.

Effective Internal Control The Framework sets forth the requirements for an effective system of internal control. An effective system of internal control reduces, to an acceptable level, the risk of not achieving an entity objective and may relate to one, two, or all three categories of objectives. It requires that:

• Each of the five components and relevant principles is present and functioning.

• The five components operate together in an integrated manner.

Limitations

The Framework recognizes that while internal control provides reasonable assurance of achieving the entity's objectives, limitations do exist. Limitations may result from the:

• Suitability of objectives established as a precondition to internal control

• Reality that human judgment in decision making can be faulty and subject to bias

• Breakdowns that can occur because of human failures such as simple errors

• Ability of management to override internal control

• Ability of management, other personnel, and/or third parties to circumvent controls through collusion

• External events beyond the organization's control

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These limitations preclude the board and management from having absolute assurance of the achievement of the entity's objectives—that is, internal control provides reasonable but not absolute assurance.

Using the Internal Control Framework

How this framework is used depends on the roles of the interested parties:

The Centre for Labour Rights (CLR) is managed by the Steering Board, which is the highest decision-making body of the Centre, the Executive Director, which is the highest executive body, and the Managers who coordinate the work in different sectors according to the determinations made by the Centre. The Steering Board consists of the Chairperson and four (4) members, experts in various academic and socio-economic fields and individuals with reputation in society. Each member is elected at the annual meeting of the Board and each of them serves for an indefinite term. Any member may resign without cause with the approval of the Board. At the first meeting, the Board elects the Chairperson of the Board. The Chairperson of the Board leads the meetings of the Board.

The executive staff of the organization consists of the Executive Director, two (2) program managers, one (1) financier, one (1) media and public relations expert. The Executive Director, together with the managers, is responsible for the daily activity and execution of the programs established by the highest decision-making body of the non-profit organization.

The Steering Board —The board should discuss with the executive director the state of the entity's system of internal control and provide oversight as needed. The executive director is accountable for internal control and to the board. The board should be apprised of the risks to the achievement of the entity's objectives, the assessments of internal control deficiencies, the management actions deployed to mitigate such risks and deficiencies, and how management assesses the effectiveness of the entity's system of internal control. The board should challenge management and ask the tough questions, as necessary, and seek input and support from internal auditors, external auditors, and others.

The Executive Director — The executive director should assess the entity's system of internal control in relation to the Framework, focusing on how the organization applies the principles in support of the components of internal control.

The staff – The staff should comply with the directives and regulations input by the Board and Executive Director and be actively involved in the internal control procedures of the organization.

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