



EAGLE Training Program

Module 3 - Top-Down, Risk-Based Approach

Learning Objectives

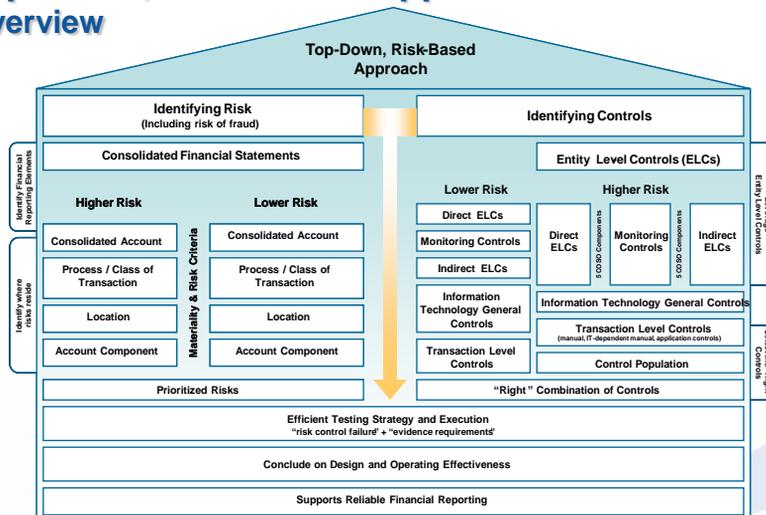
In this module, we will:

- Discuss the Top-Down, Risk-Based Approach to assessing Internal Control over Financial Reporting
- Discuss the theory behind:
 - Risk Identification (Module 4)
 - Controls Identification (Modules 5 and 6)
 - Execution and Evaluation – Controls Testing (Modules 7 and 8)

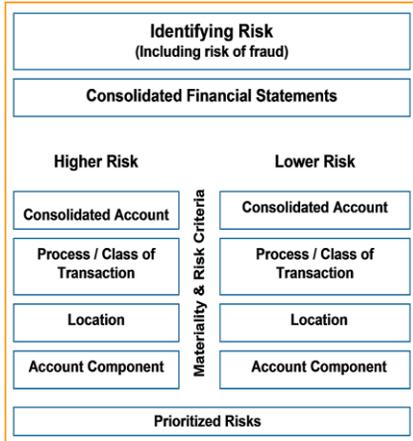
Top-Down, Risk-Based Approach: Overview

- An approach to conducting an Internal Control Assessment that:
 - Identifies the risks related to reliable financial reporting
 - Identifies the combination of controls that addresses those risks
 - Evaluates the evidence necessary to conclude on the effectiveness of such controls
- The approach rests on the premise that not all risks are equal, and management's effort should be tailored according to the nature of the identified level of risk.

Top-Down, Risk-Based Approach: Overview



Top-Down, Risk-Based Approach: Risk Identification



- In a top-down approach, the State Agency begins by identifying, understanding, and evaluating the risk at a financial statement level.
- At the financial statement account and process level, the State Agency will identify those accounts and processes that possess the quantitative (i.e. Materiality) and qualitative factors for higher or lower risk to determine the final scope.

Advantages of a Top-Down, Risk-Based Approach:

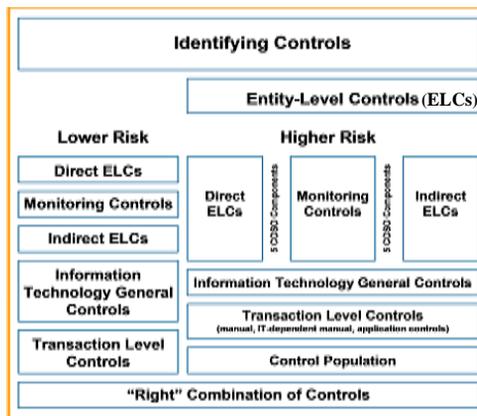
- By using a Top-Down, Risk-Based Approach, the State Agency will focus the majority of the internal control efforts on those highest risk areas and avoid performing excess work on the lowest risk areas.

Top-Down, Risk-Based Approach: Controls Identification (Design Effectiveness)

- After the State Agency has completed the risk assessment and identified those significant processes in scope, the Agency will gain an understanding of the highest risk in those processes through narratives and flowcharts.
- For those risks that exist in the transaction processing, the State Agency will identify those internal controls that would either prevent or detect an error from occurring.

Advantages of a Top-Down, Risk-Based Approach:

- By using a Top-Down, Risk-Based Approach, the State Agency will focus the internal control efforts to identifying those controls over the highest risk processes.



Top-Down, Risk-Based Approach: Execution and Evaluation (Operating Effectiveness)

- After the State Agency has completed the documentation of the significant processes and identified the “right” combination of controls, a testing strategy will be designed to focus the efforts on those controls that have been designed to prevent or detect errors of the highest risk processes.

Advantages of a Top-Down, Risk-Based Approach:

- By using a Top-Down, Risk-Based Approach, the State Agency will focus the testing and self-assessment effort to controls that provide the greatest coverage over the highest risk areas. Further, using this risk based approach will allow the agency the ability to better time and schedule the testing over the course of the entire reporting period by testing the lower risk controls earlier in the year and the moderate and highest risk controls closer to year-end.

Efficient Testing Strategy and Execution “risk control failure” + “evidence requirements”
Conclude on Design and Operating Effectiveness
Supports Reliable Financial Reporting

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Summary

In this module, we:

- Described the Top-Down, Risk-Based Approach
- Explained the concepts of:
 - Risk Identification (Module 4)
 - Controls Identification (Modules 5 and 6)
 - Execution of the Evaluation (Modules 7 and 8)
- Discussed the advantages of the Top-Down, Risk-Based Approach

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EAGLE Training Program

Break

Recap Summary

- Module 1:
 - We discussed the EAGLE Program and its significance to the State of North Carolina.
- Module 2:
 - We defined Internal Control and discussed its benefits.
- Module 3:
 - We described the Top-Down, Risk-Based Approach and discussed its advantages.