

**COSO**



The Committee of Sponsoring Organizations of the Treadway Commission

# Internal Control–Integrated Framework

January 2013



## Table of Contents

- Project Overview
- Updates to Internal Control-Integrated Framework
- Overview of Internal Control over External Financial Reporting:  
Compendium of Approaches and Examples
- Overview of Illustrative Tools for Assessing Effectiveness of a System of  
Internal Control
- Transition



## **Project Overview**



## Why Update What Works

*Original Framework (today)*

COSO's Internal Control-Integrated Framework (1992 Edition)

Fundamental concepts relating to effective internal control

Changes in business, operating, and regulatory environments

Internal and non-financial reporting objectives



Clarifies Requirements

Greater Relevance and Usefulness

Expands Application



COSO's Internal Control-Integrated Framework (Draft, 2013 Edition)

*Enhancements and clarifications to ease use and application*

*Updated Framework*





## Project Timetable





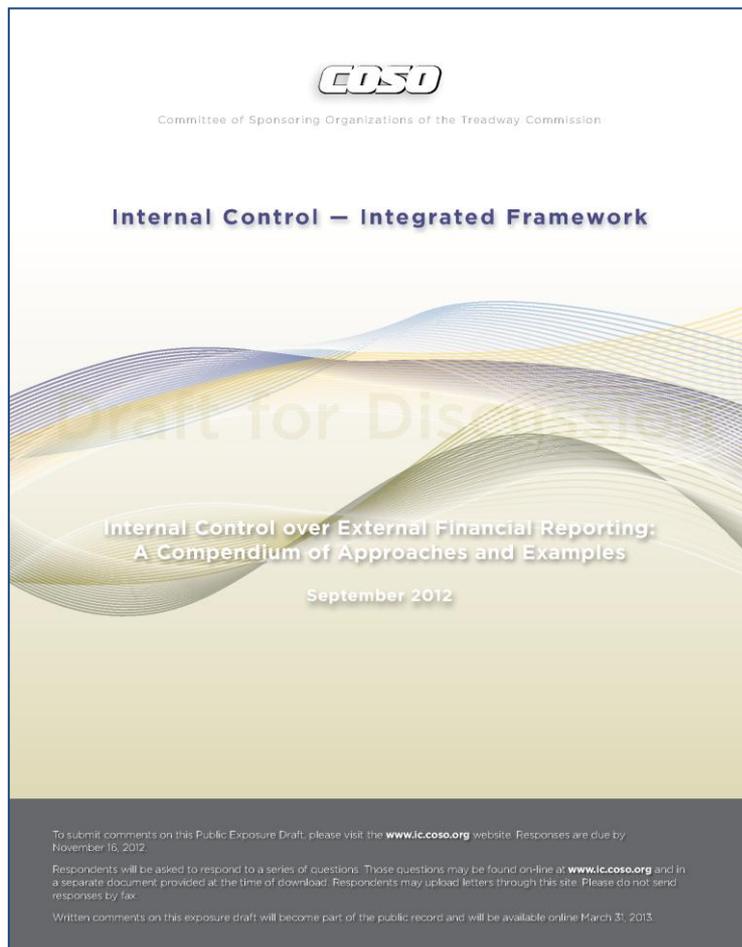
## Project Deliverables: Internal Control-Integrated Framework



- Consists of three volumes:
  - Executive Summary
  - Framework and Appendices
  - Illustrative Tools: Assessing Effectiveness of a System of Internal Control
- Sets out:
  - Definition of internal control
  - Requirements for effectiveness
  - Categories of objectives
  - Components of internal control



## Project Deliverables: Internal Control over External Financial Reporting: A Compendium



- Approaches and Examples illustrate how principles are applied in preparing financial statements for external purposes
- Compendium considers changes in business, operating, and regulatory environments during past two decades
- Compendium is relevant for variety of entities – public, private, not-for-profit, and government
- Compendium is consistent with the updated Framework

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# Updates to Internal Control–Integrated Framework



## Internal Control-Integrated Framework

- First published in 1992
- Gained wide acceptance following financial control failures of early 2000's
- Most widely used framework in the US
- Also widely used around the world



Original COSO Cube



## Updates intended to ease use and application

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### What is not changing...

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1. Retains the core definition of internal control
2. Retains the five components of internal control
3. Retains the requirement of five components for an effective of system of internal control
4. Retains important role of judgment in designing, implementing, and conducting internal control, and in assessing effectiveness of internal control



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### What is changing...

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1. Formalizes fundamental concepts underlying the five components as principles
  2. Considers changes in business, operating, and regulatory environments
  3. Expands financial reporting objective to include other important forms of reporting
  4. Provides additional approaches and examples relevant to operations, compliance, and non-financial reporting objectives
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## Update clarifies requirements for effective internal control

- Retains concept that effective internal control provides reasonable assurance regarding achievement of objectives
- Effective internal control requires that:
  - Each of the five components of internal control and relevant principles are present and functioning
  - The five components are operating together in an integrated manner
- When a component or relevant principle is deemed not present and functioning, or when components are deemed not operating together, a “major deficiency” exists
- When a major deficiency exists, the entity cannot conclude that it has met the requirements for effective internal control

An effective system of internal control reduces, to an acceptable level, the risk of not achieving an objective.



## Update formalizes fundamental concepts embedded in the original Framework as principles

### Control Environment

1. Demonstrates commitment to integrity and ethical values
2. Exercises oversight responsibility
3. Establishes structure, authority and responsibility
4. Demonstrates commitment to competence
5. Enforces accountability

### Risk Assessment

6. Specifies suitable objectives
7. Identifies and analyzes risk
8. Assesses fraud risk
9. Identifies and analyzes significant change

### Control Activities

10. Selects and develops control activities
11. Selects and develops general controls over technology
12. Deploys through policies and procedures

### Information & Communication

13. Uses relevant information
14. Communicates internally
15. Communicates externally

### Monitoring Activities

16. Conducts ongoing and/or separate evaluations
17. Evaluates and communicates deficiencies



## Update considers changes in business, operating, and regulatory environments

### *Changes in the environments...*

Expectations for governance oversight

Globalization of markets and operations

Changes in business models

Demands and complexity in laws, rules, regulations, and standards

Expectations for competencies and accountabilities

Use of, and reliance on, evolving technologies

Expectations relating to preventing and detecting fraud

### *Drive updates to the Framework...*



Updated COSO Cube



## Summary of selected public responses to on-line survey relating to proposed updates to the Framework

- Interest across geographies –approximately 50% of respondents from North America and 50% from international regions
- Concurrence that the updated Framework:
  - Will help strengthen systems of internal control
  - Provides important considerations of effective internal control through formalization of concepts introduced in the original Framework
  - Appropriately expands the reporting objective
- Divergent views exist – for instance, the updated Framework:
  - May set a higher threshold for attaining effective internal control
  - May impose additional burden on entities’ reporting on internal control
  - Should incorporate aspects of ERM-Integrated Framework, e.g., objective setting



## Summary of revisions and responses to considerations arising from public comment letters

- Definition of Internal Control
  - Removes modifiers (e.g., reliable financial reporting) from categories of objectives
- Assessing Effectiveness
  - Clarifies that effective internal control requires (i) each of the five components and relevant principles are present and functioning and (ii) the five components are operating together
  - Modifies classification of internal control deficiencies into two tiers: (i) major deficiency precludes effective internal control, (ii) other internal control deficiency
  - Clarifies that points of focus (formerly attributes) are important considerations in determining whether a principle is present and functioning
  - Removes presumption that points of focus are present and functioning, and clarifies use of judgment in identifying and considering relevant points of focus



## Summary of revisions and responses to considerations arising from public comment letters (continued)

- Enterprise Risk Management (ERM)
  - Retains distinction between ERM and Internal Control
  - Retains view that strategy-setting, strategic objectives, and risk appetite are aspects of ERM and not part of the updated Framework
  - Retains definition of risk appetite and application of risk tolerance
- Technology
  - Expands discussion in the points of focus and in several chapters
  - Excludes discussion on specific technologies and associated risks due to rapid pace of change of technology



# **Overview of Internal Control over External Financial Reporting: Compendium of Approaches and Examples (ICEFR Compendium)**



## Overview of ICEFR Compendium

- Selected Approaches and Examples illustrate various aspects of applying the principles in an ICEFR context:
  - Approaches and Examples are intended to assist users in understanding how the updated Framework can be applied when preparing financial statements for external purposes and other external financial reporting
  - Definitions, components, principles, and points of focus are consistent with the updated Framework
- Stakeholders should refer to the updated Framework for comprehensive discussion of an effective system of internal control
- Compendium supplements and can be used in concert with the updated Framework when considering ICEFR



## **Overview of Illustrative Tools for Assessing Effectiveness of a System of Internal Control**



## Overview of Illustrative Tools

- Tools include collection of Templates and Scenarios that can assist users when assessing the effectiveness of a system of internal control based on the requirements set forth in the updated Framework
- Templates help management present a summary of assessment results and its determination of whether components and principles are present and functioning
- Scenarios illustrate how Templates can be used to support an assessment of effectiveness of a system of internal control, including:
  - Is a component and relevant principles present and functioning?
  - Are the five components present, functioning and operating together in an integrated manner?
- The Illustrative Tools do not replace or modify the updated Framework



## **Transition**



## Transition to the Updated Framework

- COSO expects the updated Framework will eventually supersede the original Framework; accordingly, the ICEFR Compendium will supersede the 2006 *Internal Control over Financial Reporting - Guidance for Smaller Public Companies*
- COSO believes users should update their systems of internal control and related documentation as quickly as is feasible under the circumstances
- COSO recognizes that differing applications of the Framework and differing circumstances will impact how quickly an update can occur
- COSO will make the original Framework available following the issuance of the updated Framework until it becomes clear that transition in the marketplace has been substantially completed
- Users who are required to report upon the effectiveness of internal control should monitor guidance by regulators and standard setters for any preference regarding the framework to use for reporting purposes during the transition period
- COSO believes continued use of the original Framework during the transition period would be acceptable



## Questions or Comments?

- Direct correspondence with COSO and PwC via [icif@us.pwc.com](mailto:icif@us.pwc.com)