An Update of COSO’s Internal Control–Integrated Framework

May 2012
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
Key Concepts – Timeless

• A process
• Effected by people
• Provides reasonable assurance
• Geared to achievement of objectives related to (1) operations, (2) compliance and (3) financial reporting
• Five components of internal control:
  – Control Environment
  – Risk Assessment
  – Control Activities
  – Information and Communication
  – Monitoring
**Why Update What Works**

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<tbody>
<tr>
<td>Goals for Refresh</td>
<td>Address significant changes to the business environment and associated risks</td>
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<tr>
<td>Planned Enhancements</td>
<td>Codify criteria to use in the development and assessment of systems of internal control</td>
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<tr>
<td>ICIF will work better tomorrow</td>
<td>Increase focus on operations, compliance and non-financial reporting objectives</td>
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- Update, enhance and clarify *Framework*
- Principles
  - Attributes
- Expand internal and non-financial reporting guidance
Project Plan & Timetable

2010: Assess & Survey Stakeholders
2011: Design & Build
2012: Public Exposure & Reassess
2013: Finalize
Project Participants

**COSO Board of Directors**

**PwC Author and Project Leader**

**COSO Advisory Council**
- AICPA
- AAA
- FEI
- IIA
- IMA
- Public Accounting Firms
- Regulatory observers
- Others (IFAC, ISACA, others)

**Stakeholder Input**
- Survey of over 700 stakeholders and users of the 1992 *Internal Control – Integrated Framework*
- More than 200 stakeholders commented on the proposed updates to the *Framework* (exposure draft)
- Additional stakeholder input can be sent to icif@us.pwc.com
Summary of Updates

What’s changed...

The experienced reader will find much familiar in the updated *Framework*, which builds on what has proven effective in the original version.

**What is not changing...**

1. Definition of internal control
2. Five components of internal control
3. The fundamental criteria used to assess effectiveness of systems of internal control
4. Use of judgment in evaluating the effectiveness of systems of internal control

**What is changing...**

1. Update to reflect current conditions in business and operating environments
2. Codify principles that support the five components of internal control
3. Expand financial reporting objective to include internal reporting and external non-financial reporting
4. Increase focus on operations, compliance and reporting objectives
Summary of Updates

**Ever-changing conditions...**

- Expectations for governance oversight
- Globalization of markets and operations
- Changes in business models
- Demands and complexity of rules, regulations, and standards
- Expectations for competencies and accountabilities
- Use and reliance on evolving technology
- Expectations for preventing and detecting fraud

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

Updated COSO Cube
<table>
<thead>
<tr>
<th>Control Environment</th>
<th>Risk Assessment</th>
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<tbody>
<tr>
<td>1. Demonstrates commitment to integrity and ethical values</td>
<td>6. Specifies relevant objectives</td>
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<td>2. Exercises oversight responsibility</td>
<td>7. Identifies and analyzes risk</td>
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<tr>
<td>3. Establishes structure, authority and responsibility</td>
<td>8. Assesses fraud risk</td>
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<td>4. Demonstrates commitment to competence</td>
<td>9. Identifies and analyzes significant change</td>
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<td>5. Enforces accountability</td>
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<td>Control Activities</td>
<td></td>
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<td>10. Selects and develops control activities</td>
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<td>11. Selects and develops general controls over technology</td>
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<td>12. Deploys through policies and procedures</td>
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<td></td>
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<tr>
<td>Information &amp; Communication</td>
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<tr>
<td>13. Uses relevant information</td>
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<td>14. Communicates internally</td>
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<td>15. Communicates externally</td>
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<td>Monitoring Activities</td>
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<td>16. Conducts ongoing and/or separate evaluations</td>
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<td>17. Evaluates and communicates deficiencies</td>
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Value Proposition
Enhance performance with greater agility, confidence and clarity

The updated *Framework* better supports efforts to design and adapt systems of internal control:

- **Agility** – Adapt to increasing complexity and pace of change
- **Confidence** - Mitigate risks to achieve important objectives
- **Clarity** – Provide reliable information to support sound decision making
Benefits of the Updated *Framework*

- Improve governance
- Expand use beyond financial reporting
- Improve quality of risk assessment
- Strengthen anti-fraud efforts
- Adapt controls to changing business needs
- Greater applicability for various business models
Obtaining Stakeholder Input to Update the Framework

• Initial on-line survey conducted from January to September 2011
  – Over 700 respondents

• Ongoing input provided by COSO’s Board, Advisory Council and PwC
  – Eight meetings to-date
  – Task forces support Advisory Council members

• Direct correspondence with COSO and PwC via icif@us.pwc.com

• Public exposure of updated Framework from December 19, 2011 to March 31, 2012
  – Webcasts, conferences, roundtable events, and other meetings – more than 5,000 participants, include chief auditing executives, CIOs, Controllers, others
  – On-line survey questionnaire - over 100 respondents
  – Comment letters - 96 respondents
Public Exposure: On-line Survey Responses

- Interest across geographies – approximately 50% 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 codification of principles and related attributes
  - Appropriately expands the reporting objective

- Divergent views noted – for instance, the updated *Framework*:
  - May set a higher threshold for attaining effective internal control
  - May impose additional burdens on entities’ reporting on internal control
  - Should incorporate aspects of ERM-Integrated Framework, e.g., objective setting
The Updated Framework Will Help Strengthen Systems of Internal Control

- 79% agree
- Only 10% disagree

- 87% agree that the principles and related attributes are helpful in describing important considerations of effective systems of internal control
The Updated Framework Appropriately Expands the Reporting Objective

- 81% agree
- Only 6% disagree

- 75% agree that expanding the reporting objective does not diminish the ability to report on internal control over external financial reporting
The Updated Framework will Impose a Higher Threshold and Additional Burden

- 43% believe that it creates a higher threshold
- 34% believe that it maintains the same threshold
- 9% believe that it does not create a higher threshold

- 42% agree that it will impose additional burden on entities’ reporting on internal control
- 31% disagree
- 27% neither agree nor disagree
Summary of Public Comment Letter Responses

- Many respondents made comments on the following topics:
  - Clarify expected transition timeline and process
  - Reconsider detailed descriptions of attributes, which may trigger a checklist mentality among management and auditors
  - Combine principles 11 and 10 (Selection and Development of Control Activities and Information Technology)

- Some respondents made comments on the following topics:
  - Principles provide valuable criteria to apply the Framework
  - Add objective-setting process to the Framework
  - Eliminate use of minor and major non-conformities in assessing effectiveness
  - Expand guidance on technology
  - Expand guidance specific to smaller businesses, government, etc.
  - Call out explicitly the importance of management’s philosophy and operating style
  - Clarify differences between control activities and monitoring activities
Summary of Public Comment Letter Responses – Other topics

- Modify structure and/or layout of Framework – e.g., clarify requirements versus guidance
- Align with COSO Enterprise Risk Management-Integrated Framework
- Clarify or expand definition of internal control – e.g., embed risk, remove objective categories
- Clarify assessing effectiveness – e.g., role of attributes, classifications of deficiencies
- Expand objectives to include strategy and safeguarding of assets
- Add or modify principles and attributes
- Add or clarify controls relating to outsourcing
Development of Related Documents

• **Internal Control over External Financial Reporting (ICEFR)—Approaches and Examples**
  – A supplemental document to the updated *Framework*
  – Includes approaches and examples to assist management in applying the updated *Framework* to this sub-category of the reporting objective

• **Internal Control-Integrated Framework: Tools for Assessing Effectiveness of a System of Internal Control**
  – A supplemental document to the updated *Framework*
  – Includes templates and scenarios to assist management in determining how components and principles can be considered when assessing effectiveness of a system of internal control

• Above documents will not replace or modify the updated *Framework*
Questions or Comments?

- Please contact icif@us.pwc.com