



The Committee of Sponsoring Organizations of the Treadway Commission

Internal Control–Integrated Framework

An IAASB Overview

September 2016

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COSO & Project Overview



Originally formed in 1985, COSO is a joint initiative of five private sector organizations and is dedicated to providing thought leadership through the development of frameworks and guidance on enterprise risk management (ERM) internal control and fraud deterrence.



9,300



386,000



15,000

> 600,000



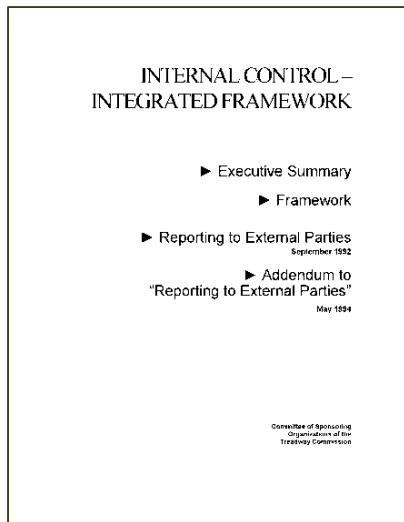
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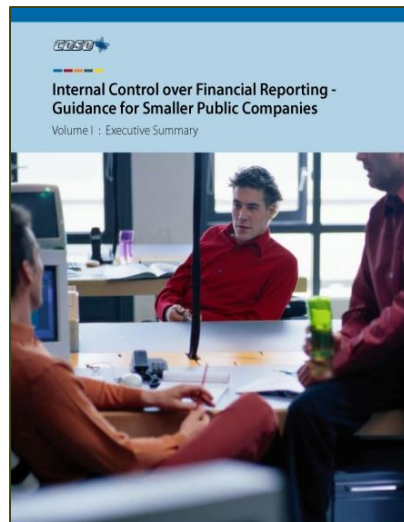
180,000

COSO Overview – Internal Control Publications

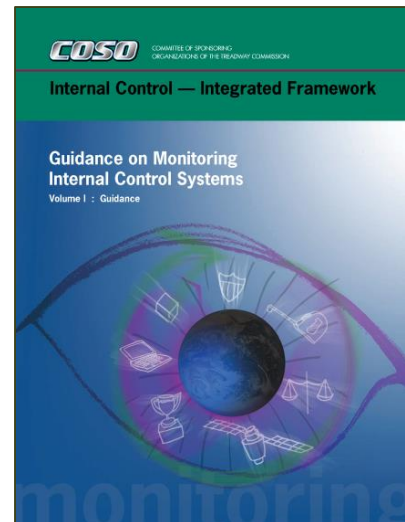
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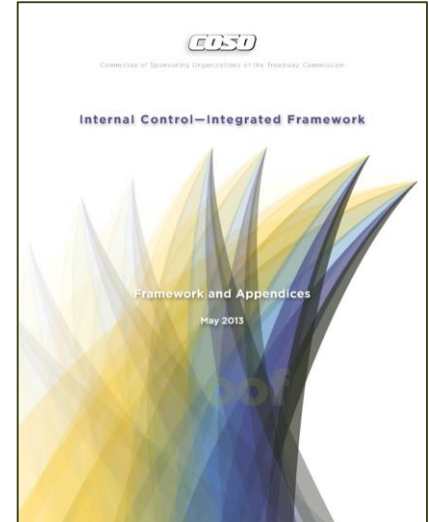
2006



2009



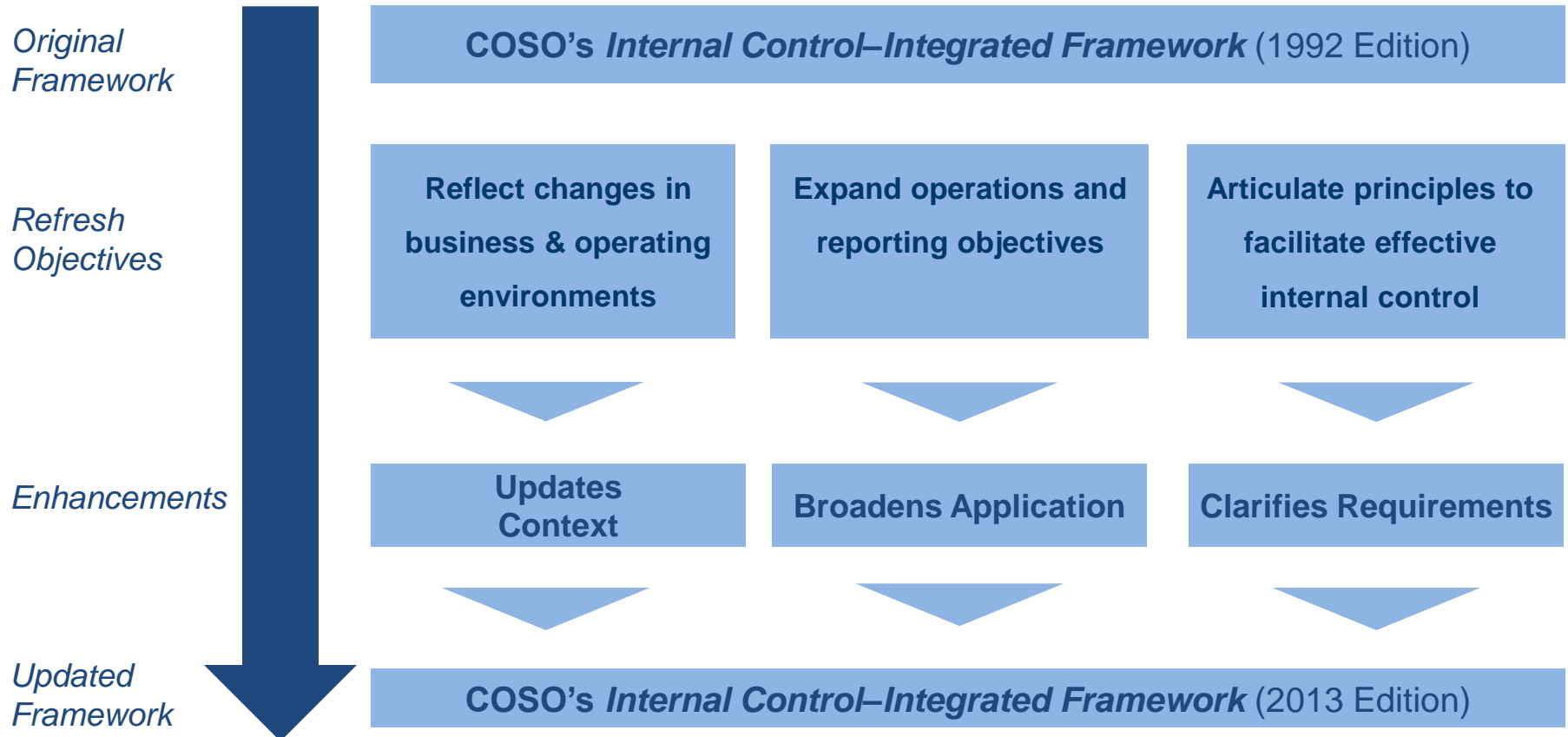
2013





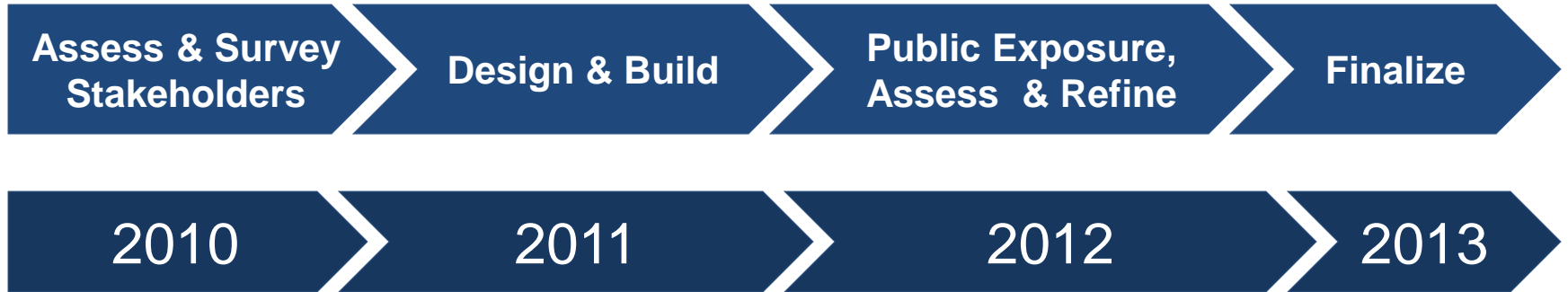
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Why update what works – The Framework has become the most widely adopted control framework worldwide.



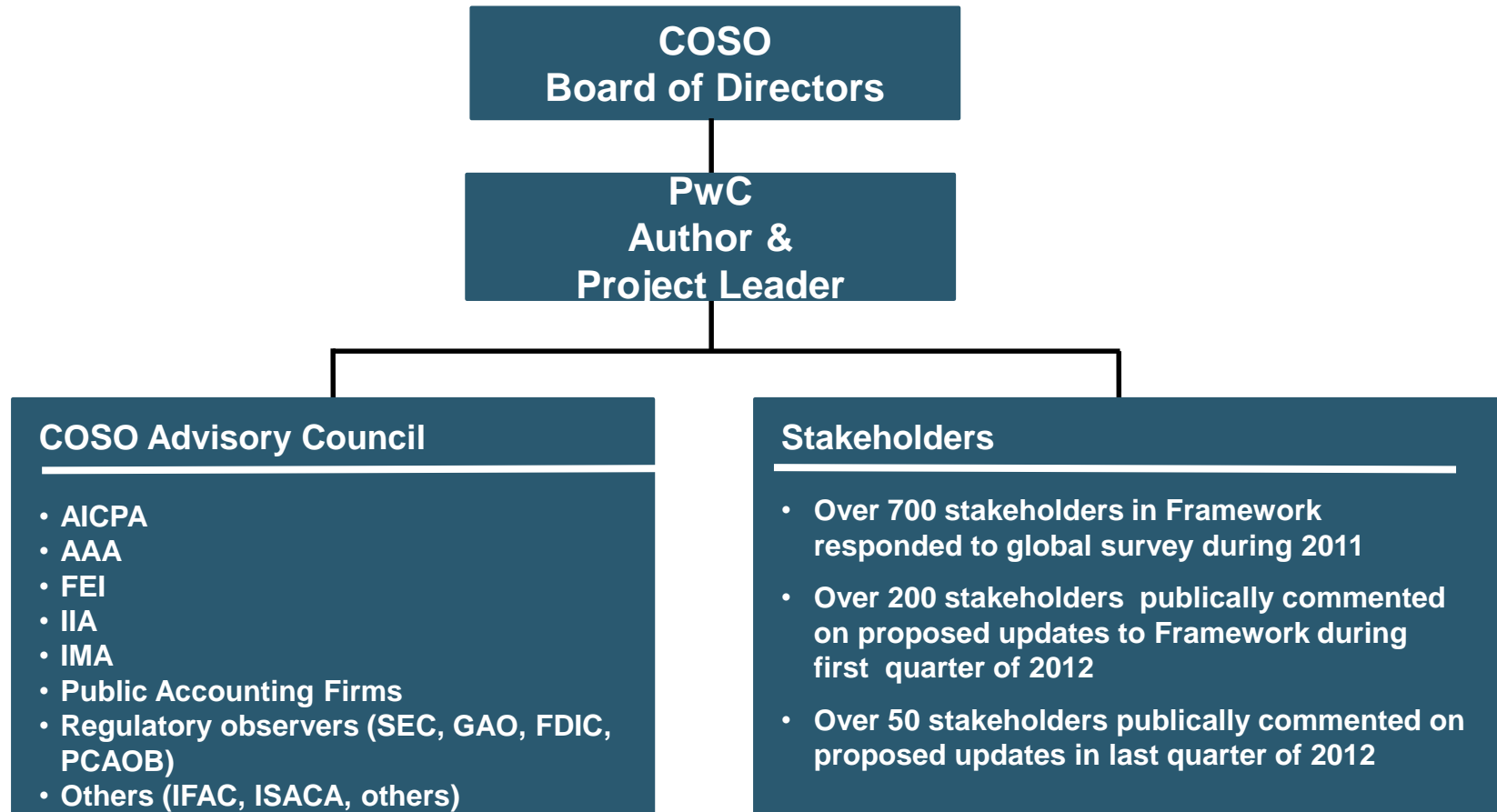


Project timetable



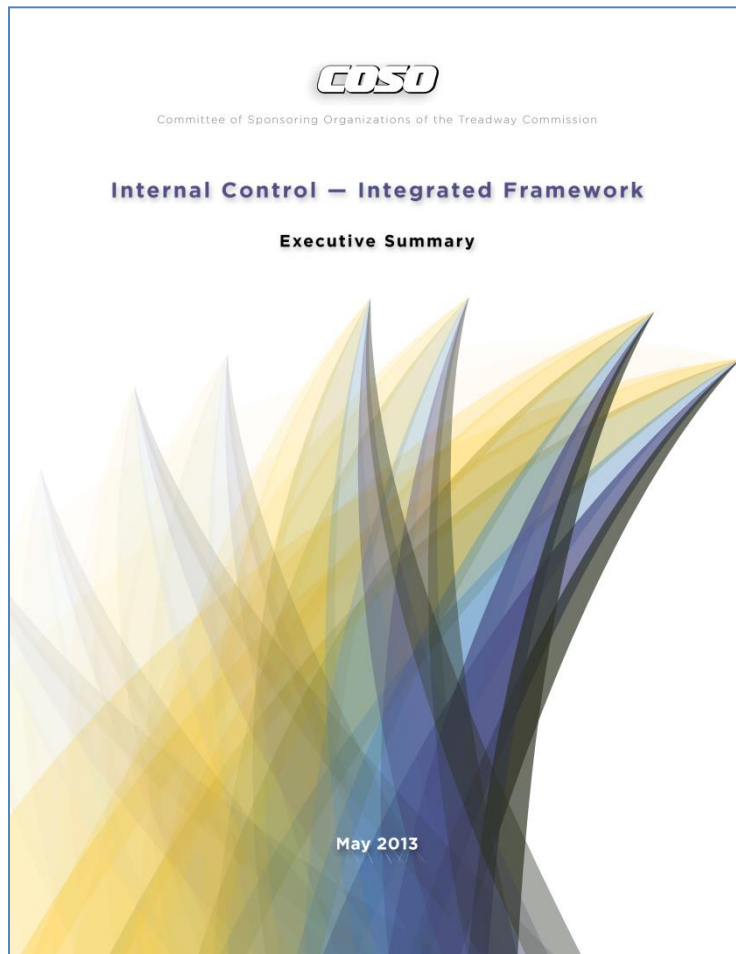


Project participants



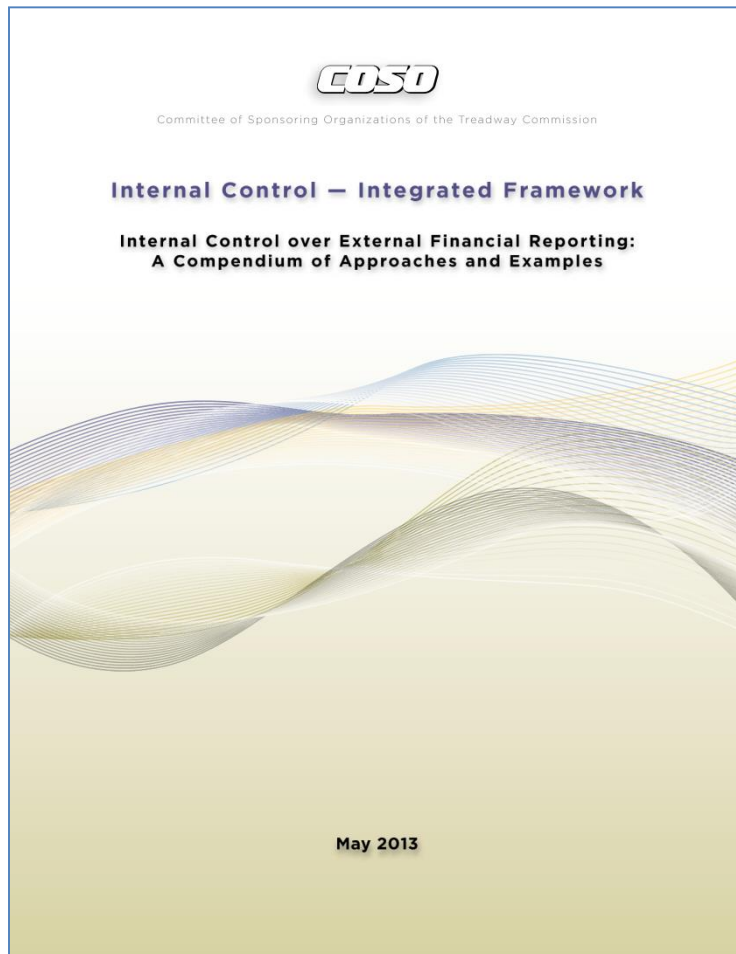


Project deliverable #1 – Internal Control-Integrated Framework (2013 Edition)



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

Project deliverable #2 – Internal Control over External Financial Reporting: A Compendium....



- Approaches and Examples illustrate how principles are applied in preparing financial statements
- Considers changes in business and operating environments during past two decades
- Relevant for variety of entities – public, private, not-for-profit, and government
- Consistent with updated Framework



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Internal Control–Integrated Framework



Update expected to ease use and application

What is not changing...

- Core definition of internal control
- Three categories of objectives and five components of internal control
- Each of the five components of internal control are required for effective internal control
- Important role of judgment in designing, implementing and conducting internal control, and in assessing its effectiveness



What is changing...

- Changes in business and operating environments considered
- Operations and reporting objectives expanded
- Fundamental concepts underlying five components articulated as principles
- Additional approaches and examples relevant to operations, compliance, and non-financial reporting objectives added

Update considers changes in business and operating environments

Environments changes...

Expectations for governance oversight

Globalization of markets and operations

Changes and greater complexity in business

Demands and complexities 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

...have driven Framework updates



COSO Cube (2013 Edition)

Update articulates principles of effective internal control

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 articulates principles of effective internal control (continued)

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.

Update articulates principles of effective internal control (continued)

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.

Update articulates principles of effective internal control (continued)

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.
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 place.

Update articulates principles of effective internal control (continued)

Information & Communication

13. The organization obtains or generates and uses relevant, quality information to support the functioning of other components of internal control.
14. The organization internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of other components of internal control.
15. The organization communicates with external parties regarding matters affecting the functioning of other components of internal control.



Update articulates principles of effective internal control (continued)

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.

Update clarifies requirements for effective internal control

- Effective internal control provides reasonable assurance regarding the achievement of objectives and requires that:
 - Each component and each relevant principle is present and functioning
 - The five components are operating together in an integrated manner
- Each principle is suitable to all entities; all principles are presumed relevant except in rare situations where management determines that a principle is not relevant to a component (e.g., governance, technology)
- Components operate together when all components are present and functioning and internal control deficiencies aggregated across components do not result in one or more major deficiencies
- A major deficiency represents an internal control deficiency or combination thereof that severely reduces the likelihood that an entity can achieve its objectives

Update describes important characteristics of principles, for instance...

Control Environment

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

Points of Focus:

- Sets the Tone at the Top
 - Establishes Standards of Conduct
 - Evaluates Adherence to Standards of Conduct
 - Addresses Deviations in a Timely Manner
-
- Points of focus may not be suitable or relevant, and others may be identified
 - Points of focus may facilitate designing, implementing, and conducting internal control
 - There is no requirement to separately assess whether points of focus are in place

Update describes the role of controls to effect principles

- Embedded within the internal control process are controls, which consist of policies and procedures. Policies reflect management or board statements of what should be done to effect control. Procedures are actions that implement policies. Organizations select and develop controls within each component to effect relevant principles.
- The Framework does not prescribe controls to be selected, developed, and deployed for effective internal control
- An organization's selection of controls to effect relevant principles and associated components is a function of management judgment based on factors unique to the entity
- A major deficiency in a component or principle cannot be mitigated to an acceptable level by the presence and functioning of other components and principles
- However, understanding and considering how controls effect multiple principles can provide persuasive evidence supporting management's assessment of whether components and relevant principles are present and functioning



Update describes the role of controls to effect principles

Component	Control Environment		
Principle	1. The organization demonstrates a commitment to integrity and ethical values.		
Controls effect multiple principles	Human Resources reviews all employees' annual confirmations to assess whether standards of conduct are understood and adhered to (Principle 1)	Management reviews potential deviations captured through the whistleblower hot-line and the underlying data and information (Principle 13)	Internal Audit separately evaluates the control environment, considering employee behaviors and whistleblower hotline results and reports thereon (Principles 16 & 17)

Summary of public exposure of proposed update

- Interest across geographic regions – approximately 50% of respondents from North America and 50% from international regions
- Proposed updates to Framework released for public comments:
 - December 20, 2011 to March 31, 2012
 - September 18, 2012 to December 4, 2012
- COSO sought comments from the general public on proposed updates, including whether the:
 - Requirements of effective internal control are clearly set forth
 - Roles of components, principles, and points of focus are clearly set forth
 - Framework remains sound, logical, and useful to management of entities of all types and sizes
- Public comment letters available at www.ic.coso.org until Dec. 31, 2013

Updates are responsive to public comments

- Principles
 - Provide clarity regarding the role of principles in designing, implementing, and conducting internal control, and assessing its effectiveness
 - Clarify descriptions of some principles, but no additional principles
- Effectiveness
 - Recognize effective internal control can provide reasonable assurance of achieving effective and efficient operations objectives (as noted before)
 - Clarify requirement that each of the components and relevant principles must be present and functioning and components must operating together
 - Remove presumption that points of focus are present and functioning, and clarify that no separate assessment of points of focus is required
 - Standardize classification of internal control deficiencies, and clarify use of only relevant criteria established in laws, rules, regulations and standards

Updates are responsive to public comments (continued)

- Objective Setting
 - Retain five components of internal control
 - Retain specification of objectives as a principle of effective internal control, but objective setting may be driven by laws, rules, regulations ,or external standards that are outside a system of internal control
- Objectives
 - Retain view that safeguarding of assets primarily relates to operations objectives, and recognize its consideration within reporting and compliance
 - Acknowledge some laws rules, regulations and standards establish safeguarding of assets as a separate category of objectives
 - Retain view that strategic objectives is not part of internal control
 - Retain operations, reporting, and compliance objective categories, and expand descriptions

Updates are responsive to public comments (continued)

- Enterprise Risk Management (ERM)
 - Retain distinction between ERM and internal control, and acknowledge these frameworks are complementary
 - Retain view that strategy-setting, strategic objectives, and risk appetite are aspects of ERM, not Internal Control-Integrated Framework
 - Retain discussion of risk appetite and application of risk tolerance
- Smaller Entities and Governments – Provide additional guidance specific to smaller entities and governments (Appendix C)
- Technology
 - Expand discussion in the points of focus and in several chapters
 - Decline suggestion to address risk associated with specific technologies because of the rapid pace of change

Updates are responsive to public comments (continued)

- Structure and Layout – Retain view that all chapters 1-10 comprise the Framework
- Due Process – COSO believes there has been a substantive due process effort to capture views on proposed update
 - Surveyed stakeholders to ascertain preferences concerning nature and extent of needed updates; 700 responses (December 2010 to September 2011)
 - Conducted eleven meetings with COSO Advisory Council
 - Provided exposure drafts of proposed updates for public comments (December 2011 to March 2012, and September to December 2012)
 - Participated in many conferences, webinars, and seminars with membership of COSO to seek views of stakeholders (January 2011 to January 2013)



Illustrative Documents:

- **Illustrative Tools for Assessing Effectiveness of a System of Internal Control**
- **Internal Control over External Financial Reporting: A Compendium of Approaches and Examples**

Illustrative Tools for Assessing Effectiveness of a System of Internal Control

- Assist users when assessing effectiveness of internal control based on the requirements set forth in the Framework
 - Templates illustrate a possible summary of assessment results
 - Scenarios illustrate practical examples of how the templates can be used to support an assessment and important considerations in performing an assessment
- Focus on evaluating components and relevant principles, not the underlying controls that affect relevant principles
- Cannot satisfy criteria established through laws, rules, regulations, or external standards for evaluating the severity of internal control deficiencies
- Can customize level and amount of detail included in the templates as management may deem necessary

Internal Control over External Financial Reporting (ICEFR): A Compendium of Approaches and Examples

- Approaches and Examples illustrate how various characteristics of principles may be present and functioning within a system of internal control relating to external financial reporting
 - Approaches are designed to give a summary-level description of activities that management may consider as they apply the Framework
 - Examples illustrate one or more points of focus of a particular principle. They are not designed to provide a comprehensive, end-to-end example of how a principle may be fully applied in practice.
 - Selected approaches and examples do not illustrate all aspects of components and relevant principles that would be necessary for effective internal control
- Stakeholders should refer to the Framework for the requirements of effective internal control
 - Compendium supplements and can be used in concert

Illustrative documents are responsive to public comments

- ICEFR: A Compendium of Approaches and Examples
 - Add or clarify specific examples, including:
 - Establishing responsibilities for reviewing financial statements
 - Monitoring investigation and reporting of whistleblower allegations
 - Monitoring identification and protection of sensitive financial information
 - Monitoring identification and analysis of risk of material misstatement due to fraud
 - Address a risk-based approach for achieving external financial reporting objectives
 - Specify suitable objectives for external financial reporting
 - Risks to achieving suitable objectives
 - Responses to risks



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Questions & Comments