Update on Transition to COSO 2013...

Robert Hirth
Chairman, COSO
October 16, 2014
“…while effective internal control requires leadership from the top, the responsibility for effective implementation of internal control resides with everyone in the organization, not just the finance function. This includes accountants, compliance officers and those involved in making contracts and supporting operations as well as those working on the production line to ensure that products produced meet quality objectives.

…the individuals that are responsible for achieving the objectives are also responsible for the quality of internal controls. “

Larry Rittenberg
Chair Emeritus, COSO
Walk Your Talk…

- The University of Wisconsin–Madison is building on the success of a recent forum to engage the campus community in a discussion about effective financial management practices and internal controls.

- “This is the start of a process – a process that will require strong collaboration all across the campus. The process will lead to higher-quality financial and business management and strengthen UW–Madison’s standing as a preeminent university.”

- The first of its kind at UW–Madison – also featured cross-campus collaboration and participation

- Developing and implementing a robust campus strategy on internal controls is expected to be a multi-year process. It will include defining participation, roles and responsibilities of leadership and staff across campus
Three Roles…

- Chairman, COSO
- Member, PCAOB Standing Advisory Group
- Chairman, IIA IPPF Re-look Task Force
Transition & Impact

• Users are encouraged to transition applications and related documentation to the updated Framework as soon as feasible

• Updated Framework will supersede original Framework at the end of the transition period (i.e., December 15, 2014)

• During the transition period, external reporting should disclose whether the original or updated version of the Framework was used
"The staff indicated the longer issuers continue to use the 1992 framework, the more likely they are to receive questions from the staff about whether the issuer's use of the 1992 framework satisfies the SEC's requirement for a suitable, recognized framework," especially after the Dec. 15, 2014, transition date.
20 Years in the Making…
A Broad Perspective…

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

Source: COSO 2013 Internal Control- Integrated framework
A Specific-Purpose Perspective
Risk Assessment is Only of…

Consolidated Financial Statements.

INCOME STATE | TOTAL COMPREHENSIVE INCOME | BALANCE SHEET | STATEMENT OF CHANGES IN EQUITY | CASH FLOW STATEMENT | NOTES

No more, no less
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

67,000

180,000
Mission

COSO’s Mission is “To provide thought leadership through the development of comprehensive frameworks and guidance on enterprise risk management, internal control and fraud deterrence designed to improve organizational performance and governance and to reduce the extent of fraud in organizations.”

COSO’s Fundamental Principle

Good risk management and internal control are necessary for long term success of all organizations.
National Commission on Fraudulent Financial Reporting formed with James C. Treadway, Jr., former SEC Commissioner and General Counsel, Paine Webber as its Chairman – becoming known as the “Treadway Commission” a private-sector initiative, was formed in 1985 to inspect, analyze, and make recommendations on fraudulent corporate financial reporting.

Source: sechistorical.org
The Internal Control Recommendation

All public companies should maintain internal controls that provide reasonable assurance that fraudulent financial reporting will be prevented or subject to early detection - this is a broader concept than internal accounting controls...

...The Commission also recommends that its sponsoring organizations cooperate on developing additional, integrated guidance on internal controls...

- Treadway Commission report
In the twenty years since the inception of the original framework, business and operating environments have changed dramatically, becoming increasingly complex, technologically driven, and global.

At the same time, stakeholders are more engaged, seeking greater transparency and accountability for the integrity of systems of internal control that support business decisions and governance of the organization.

Source: COSO September 2012
“Evolving Issues”- Back in 1992…

… in end user computing (EUC), increasing powerful microcomputers and even cheaper minicomputers allow for distributing data and computing power. Departments and line units do their own processing, often supported by a stand-alone, low cost local area network. These are user maintained systems rather than centrally developed software.”
Environmental changes... have driven Framework updates

- 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

COSO Cube (2013 Edition)
A new guide released by ISACA shows how the latest versions of the COSO Internal Control—Integrated Framework and COBIT relate and helps professionals who use both frameworks to create business value for enterprises in all industries and geographies.

Relating the COSO Internal Control—Integrated Framework and COBIT” looks at the updated COSO framework, which now includes a stronger emphasis on information technology, and examines the related COBIT 5 components. The paper outlines COBIT 5’s relationship to specific COSO principles and matches the relevant COBIT 5 framework content with the associated COSO framework concept.
“Many enterprises have been asking if the two are still complimentary. This paper answers that question with a resounding yes, and shows exactly how the two relate. By using both together, organizations can be confident that they are following proven guidance on assessing and improving their internal control practices within an effective governance structure.”

Steven Babb
Framework Committee Chair
ISACA and the IT Governance Institute
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 describes important characteristics of principles, e.g.,

**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 how various controls effect principles, e.g.,

<table>
<thead>
<tr>
<th>Component</th>
<th>Control Environment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Principle</td>
<td>1. The organization demonstrates a commitment to integrity and ethical values.</td>
</tr>
<tr>
<td>Controls embedded in other components may effect this principle</td>
<td>Human Resources review employees’ confirmations to assess whether standards of conduct are understood and adhered to by staff across the entity</td>
</tr>
<tr>
<td></td>
<td>Management obtains and reviews data and information underlying potential deviations captured in whistleblower hotline to assess quality of information</td>
</tr>
<tr>
<td></td>
<td>Internal Audit separately evaluates Control Environment, considering employee behaviors and whistleblower hotline results and reports thereon</td>
</tr>
</tbody>
</table>

*Information & Communication*  
*Monitoring Activities*
There is no Magic 17 Principles Control Checklist …

- The Framework does not prescribe controls to be selected, developed, and deployed for effective internal control
- Selection of controls is a function of management judgment based on factors unique to the entity
- How controls effect multiple principles can provide persuasive evidence
What You Need To Do…

• Read, understand and train others
• Meet with your audit firm
• Take 17 Principles inventory
• Map your Controls to Principles, consider POF’s
• Evaluate results and plan change
• Meet with your audit firm again
• Execute the transition plan, monitor change
What Will NOT Change …

- Top-down, risk-based approach
- “Scoping” the financial statements
- ICFR objectives
- Identification of processes and controls
- Walkthroughs
- Risk and Control Matrix
- Testing and reliance on work of others
- Roll-forward to year-end
- ITGC approach
- Deficiency identification, assessment and aggregation
- Deficiency, Significant Deficiency and Material Weakness Criteria
- Evaluation of significant change quarterly and other changes
Don’t Be Surprised…

• There’s some work to do
• Additional documentation
• Changes in some controls
• Lack of full response from audit firm and changes in their positions
• More, not less deficiencies
• And then, watch for “PCAOB inspection impact” in 2015, including Auditor’s Report disclosures
Mostly Smooth Sailing for Early Adopters of COSO Framework Update (?)

“Early adopters of the updated COSO framework say they're finding their existing internal controls map rather well to the newly articulated principles contained in the updated framework, although they need to bring more controls into the scope of their internal control evaluation and audit to show it.”

April 8, 2014
Way Back in June 2013…

Speaking at the Compliance Week 2013 conference in Washington, D.C., last week, executives from Raytheon and Pfizer said they haven't yet fully assessed what it will take for their companies to adopt the freshly revised Internal Control — Integrated Framework published by the Committee of Sponsoring Organizations, but at minimum they are expecting to produce new documentation. They hope, like many compliance officers who attended the conference and aired their concerns, it won't lead to the discovery of control gaps.
Microsoft Example

- Nearly complete with its implementation of the COSO update, mapping the new framework to its existing control environment and updating its controls.
- Increased the number of entity-level controls that are scoped into its Sarbanes-Oxley compliance exercise from 45 to 58 as a result of the refresh to the updated framework.
- Found its coverage was adequate, but some of the controls that met the COSO principles were not scoped into the internal control assessment and audit.
- Meant streamlining and identifying activities already doing that met the requirements, then documenting them and bringing them into scope for walkthroughs and testing.

Source: Compliance Week
Microsoft Example, Continued

- Devoted a few hundred staff hours to the project,
- Finalizing its control design with input from its audit firm, Deloitte.
- “There are still a couple of open questions we are working on with them that may result in a few more changes, but it's not substantial at this point,”
- Throughout the implementation the audit firm has targeted areas that the Public Company Accounting Oversight Board has called on auditors to pay closer attention through its inspection process, he says. They are looking more closely, for example, at risk assessments, outsourcing, and reports that are generated and relied on internally.

Source: Compliance Week
Dow’s COSO 2013 Transition:

Controls Mapping & Gap Assessment

- Performed a robust gap assessment
  - Mapped existing controls to Points of Focus and Principles

- Will not result in a significant change to Dow’s SOX compliance process or controls
  - Expanded documentation of specific attributes of certain controls
  - Will need to obtain specific evidence of operating effectiveness
  - Enhanced controls in a few areas
Leading edge companies are finding they're already addressing much of what the new framework requires,” he says. “For them, there's less concern about whether they have control gaps that they need to worry about. For companies doing the bare minimum at the other end of the spectrum, they might have a bigger task ahead of them in getting to full compliance.“

Jeff Goetz
Partner

Source: Compliance Week
Challenges…

- Demonstrating an effective ethics program
- Principle 9, having a process to identify changes, and appropriately factoring them into the risk assessment process
- Principle 13 and information quality
- Outsource service providers
- Risk assessment, including performing an effective fraud risk assessment
- Effective design of management review controls
- Segregation of duties
“Companies that went above and beyond on the original framework – most of the larger, mature public companies – haven’t seen as significant a change with the new framework, because in a lot of the new content areas, they had already implemented controls. Some new framework elements are proving nettlesome. They concern:

· **Information technology.** “If you were one of the companies that did the bare minimum around the original COSO implementation for IT, then you probably have a lot more work to do to satisfy Principle 11” of the revised framework, which describes how IT controls should be structured.

· **Outsourced service providers.** Many companies have to add controls in this area, notably those related to ethical values, code of conduct, and service-level agreements.

· **Information quality.** Although many companies already have high-level controls around information quality, with the new framework, you have to go to that extra level of detail.”
Where do you need to focus?

- Key concepts re: effective internal control have not fundamentally changed since 1992
  - Definition of internal control, components of internal control, and important role of judgment
  - Important concepts related to components of internal control have been formalized as “principles”

- Significant changes in management’s assessment of the effectiveness of ICFR are not expected

Implementation of 2013 Framework should focus on design of entity-level controls (ELCs) that demonstrate principles associated with Control Environment, Risk Assessment, Information/Communication, and Monitoring Activities are “present and functioning.”
Focus on entity-level controls

- ELCs typically support principles in Control Environment, Risk Assessment, Information/Communication, and Monitoring Activities
  - These controls cannot directly prevent or detect on a timely basis a misstatement of the financial statements

- Mapping ELCs to principles and evaluating related control design may identify “gaps” that need attention

- Documentation of mapping ELCs and related control design can provide “reasonable support” that principles are “present”

- Evaluating design and implementation of some ELCs may be sufficient for testing operating effectiveness, providing “reasonable support” that principles are “functioning”
“At a minimum, organizations adopting the 2013 framework will need to evaluate whether their existing system of internal control addresses the elements of the 2013 framework and update their existing documentation to demonstrate compliance with the 17 principles.”
The transition to COSO 2013 may require more time and resources than expected. “Depending on how robust their existing internal control systems are, some companies are going to be surprised by the resources and effort this transition will require.”

17% of webcast listeners said they expect the COSO transition to be a “significant” undertaking in terms of time and resources. Others expect the effort to be moderate (47%) or minor (12%), but for a full 24%, time and resource requirements are still unclear. Companies may also be (pleasantly) surprised by internal controls they already have in place—which they may be able to take credit for under COSO 2013: “If your transition process is truly an enterprise-wide effort—which it should be—odds are, you’re going to find internal controls that already map to the updated COSO Framework. Make sure you take credit for those.”
WHERE THE RUBBER MEETS THE ROAD.
Management’s Report on Internal Control over Financial Reporting…

Management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, as amended). Management assessed the effectiveness of the Company’s internal control over financial reporting as of December 31, 2013, using criteria established in *Internal Control-Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and concluded that the Company maintained effective internal control over financial reporting as of December 31, 2013.
Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control—Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company’s management is responsible for these financial statements and financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management’s Report on Internal Control over Financial Reporting appearing in Item 9A. Our responsibility is to express opinions on these financial statements, on the financial statement schedule, and on the Company’s internal control over financial reporting based on our integrated audits.
Many Firms, But One Framework
Same Destination, Slightly Different Path
Webcast survey found:

- 20% have completed a “preliminary gap assessment and transition plan,”
- 20% have “mapped their controls to COSO’s 17 principles,”
- 11% have identified and remediated control gaps,
- 11% have evaluated their system of internal controls under COSO 2013, and
- 38% said “no significant transition activities have been undertaken.”
Don’t Rush it? A Risk-free Decision?

• “If the company isn’t well into the process already and doesn’t have the resources in place to make the transition in 2014, don’t rush it.

• The SEC has stated that it doesn’t intend to challenge companies—at least in the near-term—that don’t transition by December 15, 2014.)

• If the company decides not to complete the transition in 2014, be prepared to communicate/disclose that to investors and regulators

• COSO 2013 is “an important opportunity to improve the efficiency and effectiveness of the business.”
DO NOT BE CONFUSED!!!!!!!!!!!!

• You presumably passed ICFR effectiveness last year

• This is evolution, not revolution (1992 VS. 2013)

• You MUST:
  – study the materials, learn AND APPLY the revised framework
  – Communicate, educate internally, WORK WITH PEERS
  – Work closely with your accounting firm
  – Get out of denial on issues
  – Believe in your conclusions and be able to support them

• Be aware of the PCAOB issues on ICFR- this drives audit focus, firm approach and challenges

• THIS IS NOT ABOUT PERFECTION- YOU WILL HAVE DEFICIENCIES
PCAOB Staff Practice Alert #11-
GET IT AND READ IT

- Risk assessment and the audit of internal control
- Selecting controls to test
- Testing management review controls
- Information technology ("IT") considerations, including system-generated data and reports
- Roll-forward of controls tested at an interim date
- Using the work of others
- Evaluating identified control deficiencies
<table>
<thead>
<tr>
<th>PCAOB Auditing Standards</th>
<th>Issuers</th>
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<tbody>
<tr>
<td>AS No. 9, Audit Planning</td>
<td>J</td>
</tr>
<tr>
<td>AS No. 12, Identifying and Assessing Risks of Material Misstatement</td>
<td>N</td>
</tr>
<tr>
<td>AS No. 14, Evaluating Audit Results</td>
<td>A, B, H, J, N, P, and S</td>
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<tr>
<td>AS No. 15, Audit Evidence</td>
<td>D, E, H, J, K, and R</td>
</tr>
<tr>
<td>AU Section 322, The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements</td>
<td>A, B, G, and O</td>
</tr>
<tr>
<td>AU Section 324, Service Organizations</td>
<td>F</td>
</tr>
<tr>
<td>AU Section 328, Auditing Fair Value Measurements and Disclosures</td>
<td>E, J, T, U, and BB</td>
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<tr>
<td>AU Section 329, Substantive Analytical Procedures</td>
<td>A, K, L, N, and S</td>
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<tr>
<td>AU Section 331, Inventories</td>
<td>B</td>
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<tr>
<td>AU Section 342, Auditing Accounting Estimates</td>
<td>A, D, E, H, O, and S</td>
</tr>
<tr>
<td>AU Section 350, Audit Sampling</td>
<td>A, B, C, E, F, G, J, K, P, Q, and V</td>
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</tbody>
</table>
KEEP CALM AND BE CONFIDENT
Lest We Forget...

Congress Passed the SOX Legislation during a Period of Corporate Scandals

- Market peak.
- Enron CEO Jeff Skilling resigns.
- Tyco CEO Dennis Kazowski resigns and is indicted by SEC.
- WorldCom announces it understated expenses by $3.8 billion.
- 9/11
- SOX passes House.
- SOX passes Senate.
- SOX signed into law.

Source: Bloomberg.
COSO Can Help ALL Organizations!
Getting COSO Publications

The updated Framework and related Illustrative documents are available in 3 layouts

1. **E-book** – This layout is ideally suited for those wanting access in electronic format for tablet use. An e-book reader from the AICPA is required to view this layout. Printing is restricted in this layout.
   - Purchase through [www.cpa2biz.com](http://www.cpa2biz.com)

2. **Paper-bound** – This layout is ideally suited for those wanting a hard copy.
   - Purchase through [www.cpa2biz.com](http://www.cpa2biz.com)

3. **PDF** – This layout is ideally suited for organizations interested in licensing multiple copies.
   - Contact the AICPA at [copyright@aicpa.org](mailto:copyright@aicpa.org)
Internal Control–Integrated Framework

A Suitable Model for ALL
COSO Releases New Thought Leadership Paper Demonstrating How Frameworks Improve Organizational Performance and Governance

Management and Governance Processes

Governance
Starts with the organization’s vision and mission and consists of the oversight from the board across the enterprise’s planning and operations

Strategy Setting
Is the process by which management articulates a high level plan for achieving goals consistent with mission

Diagram:
- Plan
- Business Planning
- Execution
- Monitoring
- Study
- Adapting
- Act
- Do
Proposed Enhancements to The Institute of Internal Auditors International Professional Practices Framework (IPPF)
August 4, 2014
What the Taskforce Has Recommended ...

• The RTF is **not** proposing changes to the **content** or continued relevance of the following IPPF elements:
  
  ✓ The Definition of Internal Auditing
  ✓ The Code of Ethics
  ✓ The International Standards for the Professional Practice of Internal Auditing (The *Standards*)
  ✓ Currently existing Strongly Recommended Guidance **content**:
    ✓ Practice Guides
    ✓ Practice Advisories
    ✓ Position Papers

  However, as we will discuss, the recommendations of the taskforce will impact the content over time.
What the Taskforce Has Recommended ...

• Addition of:
  – The Mission of Internal Auditing
  – The Core Principles for the Professional Practice of Internal Audit
  – Capability to produce Emerging Issues Guidance

• Introduction of:
  – Implementation Guidance (to replace and enhance Practice Advisories)
  – Supplemental Guidance (to replace and enhance Practice Guides)

• Removal of Position Papers from IPPF

• Renaming Key Elements:
  – Mandatory to Required
  – Strongly Recommended to Recommended

But Why?
Proposal 1 - The Mission of Internal Auditing

- Expand the IPPF to include a Mission statement to support the Internal Audit profession.

“To enhance and protect organizational value by providing stakeholders with risk-based, objective and reliable assurance, advice and insight.”
Proposal 2 - The Core Principles for the Professional Practice of Internal Auditing

Taken as a whole ...

1. Demonstrates uncompromised integrity.
2. Displays objectivity in mindset and approach.
3. Demonstrates commitment to competence.
4. Is appropriately positioned within the organization with sufficient organizational authority.
5. Aligns strategically with the aims and goals of the enterprise.
6. Has adequate resources to effectively address significant risks.
7. Demonstrates quality and continuous improvement.
8. Achieves efficiency and effectiveness in delivery.
10. Provides reliable assurance to those charged with governance.
11. Is insightful, proactive, and future-focused.
12. Promotes positive change.
What the Taskforce Has Recommended ...

• Reposition the nomenclature of guidance elements:
  – “Practice Advisories” to “Implementation Guidance” and
  – “Practice Guides” to “Supplemental Guidance”

WHY? To better reflect the nature of what each of these layers of the IPPF should accomplish: either to help **implement** the *Standards* or **supplement** the rest of the framework with specific examples.
What the Taskforce Has Recommended ...

• Introduce the capability to produce Emerging Issues Guidance that underpins and support the entire framework.

WHY? Current IPPF diligence processes supporting the promulgation of guidance are comprehensive and thorough, however, resultantly, this limits the ability to support the profession with quick guidance of a less authoritative nature expeditiously.
So, It Might Look Like This...
Thank You!