COSO 2013

Presented by:
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April 8, 2014
Our Time with You

• COSO Background
• Why COSO 2013?
• What Has Changed?
• Principles Overview
• Implementation Tasks and Challenges
COSO Introduction

1992

No SOX and No PCAOB

Global Supply Chains were immature

ACFE organization was only 4 years old

....and no mobile devices or bring your own device policies
The National Commission on Fraudulent Financial Reporting was formed in 1985 with James C. Treadway, Jr., former SEC Commissioner and GC, Paine Webber as its Chairman. The “Treadway Commission” was formed as a private sector initiative to inspect, analyze and make recommendations on fraudulent corporate financial reporting.
The Overarching 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
COSO Sponsoring Organizations

- AICPA
- IMA
- American Accounting Association
- FEI
COSO Introduction

20 years ago.....

• Senator Paul Sarbanes and Congressman Michael Oxley were not yet famous.
• Most of the developments in business and technology that we take for granted today had not been realized
• Companies were just starting to connect through EDI
• Smartphones did not exist
• Global financial crisis was still many years away
• China had not yet committed to a modified market economy
• Internal Control evaluation was relatively unsophisticated
• Large accounting firms maintained lists of controls for their auditors to check off
• Internal Auditors struggled to address evolving client-server networks
• Many of today’s financial reporting regulations had yet to be written

Source: Internal Auditor August 2013
Why COSO 2013?
Breaking Story - May 14, 2013

What's New
May 14, 2013

2013 Internal Control-Integrated Framework Released

COSO has issued the 2013 Internal Control–Integrated Framework (Framework). The Framework published in 1992 is recognized as the leading guidance for designing, implementing and conducting internal control and assessing its effectiveness. The 2013 Framework is expected to help organizations design and implement internal control in light of many changes in business and operating environments since the issuance of the original Framework, broaden the application of internal control in addressing operations and reporting objectives, and clarify the requirements for determining what constitutes effective internal control.

COSO has also issued Illustrative Tools for Assessing Effectiveness of a System of Internal Control and the Internal Control over External Financial Reporting (ICEFR): A Compendium of Approaches and Examples. The Illustrative Tools are expected to assist users when assessing whether a system of internal control meets the requirements set forth in the updated Framework. The ICEFR Compendium is particularly relevant to those who prepare financial statements for external purposes based upon requirements set forth in the updated Framework.

Read Press Release
Download Executive Summary
Read FAQs
Download PowerPoint Slides
Purchase Framework and Tools
Why COSO 2013?

- Definition: COSO is a leading framework for designing, implementing, and conducting internal control and assessing the effectiveness of internal control.

- Business and operating environments have changed dramatically, becoming increasingly complex, technology driven, and global.

- Stakeholders are more engaged, seeking transparency and accountability.

- Increased expectations for risk assessments at all levels of the organization (financial, operations, regulatory, IT).
Why COSO 2013 (Continued)

- Complexities in laws, regulations and standards have increased significantly
- Large scale governance and internal control breakdowns have occurred in the last 20 years
- Heightened expectations regarding fraud prevention and detection at many levels
- A demand for updated and improved internal and external reporting
What’s New In The 2013 Framework?
COSO 2013 Framework

Seven changes in the updated Framework that will affect:

• Scope of Internal Audit Activities

• Nature of Internal Audit work, including the need for more judgment by the auditor and the documentation of audit assessments especially within the evaluation of Internal Control Over External Financial Reporting
Much has happened since 1992. Several changes in the business environment have driven the compelling need for an Update:

<table>
<thead>
<tr>
<th>Environment changes</th>
<th>...have driven Framework updates</th>
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<tbody>
<tr>
<td>Expectations for governance oversight</td>
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<tr>
<td><strong>Globalization</strong> of markets and operations</td>
<td></td>
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<tr>
<td>Changes and greater complexity in <strong>business models</strong></td>
<td></td>
</tr>
<tr>
<td>Demands and complexities in <strong>laws, rules, regulations, and standards</strong></td>
<td></td>
</tr>
<tr>
<td>Expectations for competencies and accountabilities</td>
<td></td>
</tr>
<tr>
<td>Use of, and reliance on, <strong>evolving technologies</strong></td>
<td></td>
</tr>
<tr>
<td>Expectations relating to preventing and detecting <strong>fraud</strong></td>
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COSO Cube (2013 Edition)
COSO Project Deliverable #1

- 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 and principles of internal control
  - Requirements for effectiveness
COSO Project Deliverable #2

- Illustrates approaches and examples of how principles are applied in preparing financial statements
- Considers changes in business and operating environments during past two decades
- Provides examples from a variety of entities – public, private, not-for-profit, and government
- Aligns with the updated Framework
Summary of Changes

The Update increases ease of use and broadens 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...

- 17 Principles codified
- Role of objective setting clarified
- Reflects increased role and relevance of technology
- Incorporates enhanced discussion of governance
- Expands “Reporting” objective
- Enhances consideration of anti-fraud expectations
- Increases focus on non-financial reporting objectives
What Has Changed?
What has changed?

• **Principles and Points of Focus**
  – Codifies 17 principles that support the 5 components of internal control

• **Reporting Objectives**
  – Major change regarding how information is reported within and outside the company

• **Accountability for Internal Controls**
  – Principles place increased emphasis on individual competence and accountability
What has changed? (Continued)

• Anti-Fraud Risk Considerations
  – Separate principle established for fraud controls

• Increased Relevance of Technology
  – Technological use and complexity has grown substantially over 20 years

• Compliance and Operational Objectives
  – Reasserts the importance of compliance and operations objectives
What has changed? (Continued)

• Modification of Classification of Failures
  – New Framework modifies the classification of internal controls failures into two tiers:
    • **Major Deficiency:**
      – A deficiency, or combination of deficiencies, that is severe enough to adversely affect the likelihood an entity can achieve its objectives.
    • **Internal Control Deficiency:**
      – A shortcoming in a relevant principle or component that has the potential to adversely affect the ability of the entity to achieve its objective.
  • To date, the PCAOB has not provided guidance regarding changes to the SOX nomenclature.
Principles Overview
Seventeen Principles

• Represent the fundamental concepts associated with each component

• All principles apply to operations, reporting, and compliance objectives

• An entity can achieve effective internal control by applying all principles
Control Environment – 5 Principles

1. Organization demonstrates a commitment to integrity and ethical values.

2. 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. Organization demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.

5. Organization holds individuals accountable for their internal control responsibilities in the pursuit of objectives.
Risk Assessment – 4 Principles

6. Organization specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives.

7. 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. Organization considers the potential for fraud in assessing risks to the achievement of objectives.

9. Organization identifies and assesses changes that could significantly impact the system of internal control.
Control Activities – 3 Principles

10. Organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.

11. Organization selects and develops general control activities over technology to support the achievement of objectives.

12. Organization deploys control activities through policies that establish what is expected and procedures that put policies into action.
Information and Communication – 3 Principles

13. Organization obtains or generates and uses relevant, quality information to support the functioning of internal control.

14. Organization internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of internal control.

15. Organization communicates with external parties regarding matters affecting the functioning of internal control.
Monitoring Activities – 2 Principles

16. Organization selects, develops, and performs ongoing and/or separate evaluations to ascertain whether the components of internal control are present and functioning.

17. 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.
Implementation Tasks & Challenges
Timeline

• Original framework will remain available and deemed appropriate for use through Dec. 15, 2014.

• SEC staff plans to monitor the transition for issuers using the 1992 framework to evaluate whether and if any staff or Commission actions become necessary or appropriate at some point in the future.
# COSO 2013: SOX Transition Methodology

## Build Internal Awareness and Expertise
- **Build Awareness**
  - Obtain COSO Publications
- **Revisit Concepts and Definitions**
  - Internal Control Definition
  - Categories of Objectives
  - Control Components
  - Entity Structure
  - Management Judgment
- **Understand the Principles**
  - Principles (17)
  - Points of Focus (81)
  - Approaches
  - Examples
- **Understand Definition of Effective Internal Control**
  - Present and Functioning
- **Understand the Definition of Internal Control Deficiencies**

## Perform Impact Assessment/ Prepare Project Plan
- **Revisit Existing Controls Documentation to Determine Adequacy**
  - Financial Reporting Objectives
  - Risk Assessments
  - Significant Accounts / Disclosures
  - Assertions
  - Processes and Transactions
- **Define the Project Plan and Methodology**
  - Finalize Methodology and Approach
  - Define the Project Team
  - Develop the Project Plan

## Execute the Transition Plan
- **Documentation and Evaluation**
  - Map the Principles and Components (Using Points of Focus, Approaches, and Examples) to the Existing Documentation
  - Confirm Existing Understanding with Control Owners
- **Control Design Evaluation and Gap Remediation**
  - Evaluate the Control Design
  - Define Gaps
  - Remediate Identified Gaps
- **External Review**
  - Coordinate with External Auditor

## Engage, Communicate and Train
- **Engage Broader Organization**
- **Communicate with Key Stakeholders**
- **Perform Training**

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### Overall Project Management

| Experis | April 8, 2014 | 32 |
Publications

1. Executive Summary
2. Framework and Appendices
3. Illustrative Tools for Assessing Effectiveness of a System of Internal Control
4. Internal Control over External Financial Reporting: A Compendium of Approaches and Examples
# Integrated Framework – Illustrated Tools

## 1. Overall Assessment of a System of Internal Control

<table>
<thead>
<tr>
<th>Overall Assessment of a System of Internal Control</th>
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</thead>
<tbody>
<tr>
<td>Entity or part of organization structure subject to the assessment (entity, division, operating unit, function)</td>
<td></td>
</tr>
<tr>
<td>Objective(s) being considered for the scope of internal control being assessed</td>
<td>Considerations regarding management’s acceptable level of risk assessed</td>
</tr>
<tr>
<td>Operations</td>
<td></td>
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<tr>
<td>Reporting</td>
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<td>Compliance</td>
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</table>

<table>
<thead>
<tr>
<th></th>
<th>Present? (Y/N)</th>
<th>Functioning? (Y/N)</th>
<th>Explanation/Conclusion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Control Environment</td>
<td></td>
<td></td>
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<tr>
<td>Risk Assessment</td>
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<tr>
<td>Control Activities</td>
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<td>Information and Communication</td>
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<tr>
<td>Monitoring Activities</td>
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</tbody>
</table>

Are all components operating together in an integrated manner? Evaluate if a combination of internal control deficiencies, when aggregated across components, represent a major deficiency*<br>Update Summary of Deficiencies Template as needed

<table>
<thead>
<tr>
<th>Is the overall system of internal control effective? &lt;Y/N&gt;*</th>
<th></th>
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<tbody>
<tr>
<td>Basis for conclusion</td>
<td></td>
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</tbody>
</table>

* If it is determined that there is a major deficiency, management must conclude that the system of internal control is not effective.
# Integrated Framework – Illustrated Tools

## 2. Component Evaluation

### Component Evaluation – Control Environment

<table>
<thead>
<tr>
<th>Identification No.</th>
<th>Internal control deficiency description</th>
<th>Present? (Y/N)</th>
<th>Functioning? (Y/N)</th>
<th>Explanation/Conclusion</th>
<th>Is internal control deficiency a major deficiency? (Y/N)</th>
<th>Comments/Compensating Controls</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Demonstrates Commitment to Integrity and Ethical Values—The organization demonstrates a commitment to integrity and ethical values.</td>
<td>Evaluate internal control deficiency severity: (Consider whether controls to effect other principles within and across components compensate for the internal control deficiency.)</td>
<td>List internal control deficiencies related to another principle that may impact this internal control deficiency</td>
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</table>
### 3. Principle Evaluation

**Principle Evaluation – Control Environment**

**Principle 1: Demonstrates Commitment to Integrity and Ethical Values**

The organization demonstrates a commitment to integrity and ethical values.

**Points of Focus**

- **Sets the Tone at the Top** – The board of directors and management at all levels of the entity demonstrate through their directives, actions, and behavior the importance of integrity and ethical values to support the functioning of the system of internal control.

- **Establishes Standards of Conduct** – The expectations of the board of directors and senior management concerning integrity and ethical values are defined in the entity’s standards of conduct and understood at all levels of the organization and by outsourced service providers and business partners.

- **Evaluates Adherence to Standards of Conduct** – Processes are in place to evaluate the performance of individuals and teams against the entity’s expected standards of conduct.

- **Addresses Deviations in a Timely Manner** – Deviations of the entity’s expected standards of conduct are identified and remedied in a timely and consistent manner.

- (Other entity specific points of focus, if any)
### Integrated Framework – Illustrated Tools

**Summary of Controls to Effect Principle 1**

<table>
<thead>
<tr>
<th>Deficiencies Applicable to Principle 1</th>
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<tbody>
<tr>
<td>Identification No.</td>
</tr>
<tr>
<td>Preliminary Severity – Is internal control deficiency a major deficiency? (Y/N)</td>
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</table>

Evaluate deficiencies within the principle:* 
Evaluate if any internal control deficiencies or combination of internal control deficiencies, when considered within the principle, represent a major deficiency.** 
*Update Summary of Deficiencies Template as required*

Evaluate the principle using judgment.**

Is the principle present?

Is the principle functioning?

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*Experis | April 8, 2014*
## 4. Summary of Deficiencies

### Summary of Deficiencies

<table>
<thead>
<tr>
<th>ID #</th>
<th>Source of the internal control deficiency</th>
<th>Internal Control Deficiency Description</th>
<th>Severity Considerations</th>
<th>Is internal control deficiency a major deficiency? (Y/N)</th>
<th>Owner</th>
<th>Remediation Plan and Date</th>
<th>Impact on Present/Functioning</th>
<th>List any internal control deficiencies in other principles that may have contributed to this internal control deficiency</th>
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Changes for Internal Audit To Consider
Best Next Actions

- Read COSO’s updated Framework and illustrative documents
- Educate the audit committee, C-suite, operating unit and functional management
- Establish a process for identifying, assessing, and implementing necessary changes in controls and related documentation
- Develop and implement a transition plan timely to meet key objectives – e.g., apply updated Framework by December 31, 2014 for external reporting
Three Phase Transition Approach

1. Build awareness and expertise among the control and compliance staff.
2. Develop a stakeholder communication plan.
3. Assess existing controls against the updated framework.
4. Implement the new framework.
Four Steps in the Transition

1. Build internal awareness of the updated framework by reinforcing the concepts that stay the same and educate employees on the changes, why the changes were made and how employees’ responsibilities will change.

2. Identify which stakeholders will be affected by the changes. Note the role each stakeholder will play in the transition; communicate your team’s progress to stakeholders. Provide clear guidance on what stakeholders’ responsibilities during the transition will be.

3. Use a gap assessment to determine how existing controls map to the new framework, identifying areas for improvement.

4. Create and implement a remediation plan that addresses the changes; link your company’s controls to the new framework’s principles and points of focus.
Strategic Leadership for Internal Audit

Internal Audit should provide leadership in implementing the principles in the updated framework by:

• Expanding internal coverage to include compliance and operations objectives
• Working with the controllers department and organizational process owners to evaluate controls by implementing a risk-centric approach to identify the need for controls as well as any potential control overlap
• Taking a leadership role in understanding the key features and principles underlying the updated framework and communicating them to management, process owners and the audit committee
• Developing an audit plan regarding internal controls – with specific objectives, strategies, and measurable goals – and presenting it to senior management and the audit committee for discussion

Source: Internal Auditor August 2013
2014 Implementation Insight

• Most organizations are on the sidelines waiting to see others implement first to gain from lessons learned.

• Substantial changes are unlikely required by companies to bridge from 1992 version to the updated 2013 Framework

• Socialize new framework with key executives within your organization

• Complete a gap analysis of new framework to existing controls in place

• Create a project plan to implement the new COSO Framework

Source: Internal Auditor August 2013
Questions
Contact Information

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