Agenda

• COSO’s *Internal Control-Integrated Framework (2013)*
• Transitioning ICFR to *2013 Framework*
What action has your organization taken in response to COSO’s 2013 Framework?

A. Had discussions with senior management and the Board on the potential impacts
B. Started mapping existing ICFR to 2013 Framework
C. Started mapping other systems of internal control to 2013 Framework
D. Completed mapping exercise(s) to 2013 Framework
E. Plan to perform assessment(s) next year
F. Do not plan to take any action / Do not know
COSO’s Internal Control-Integrated Framework (2013)
What is COSO?

**Internal Control Publications**

- **1992**
  - Internal Control — Integrated Framework
  - Executive Summary
  - Framework
  - Reporting to External Parties
  - Appendix to "Reporting to External Parties"

- **2006**
  - Internal Control over Financial Reporting — Guidance for Smaller Public Companies
  - Volume I: Executive Summary

- **2009**
  - COSO Internal Control — Integrated Framework
  - Guidance on Monitoring Internal Control Systems
  - Volume I: Guidance

- **2013**
  - COSO Internal Control — Integrated Framework
  - Executive Summary

**Enterprise Risk Management and Other Publications**

- **2004**
  - Enterprise Risk Management — Integrated Framework
    - Executive Summary

- **2010**
  - An Analysis of U.S. Public Companies

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Why update 1992 Framework?

Changes in the business environment

Changes inside the business

Lack of clarity

Lack of understanding

Do stakeholders understand requirements of effective internal control?

Source - COSO's survey of users and stakeholders, worldwide – January to September 2011
2013 Framework preserves core strengths embedded in 1992 Framework

What is NOT fundamentally 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
### 2013 Framework increases ease of use

**Refresh Objectives**

- Consider changes in business & operating environments
- Articulate principles to facilitate effective internal control
- Expand operations and reporting objectives

**Updates**

- Update Context
- Clarify Requirements
- Broaden Application

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2013 Framework articulates principles and points of focus

Principles articulate fundamental concepts of components
Points of focus describe important characteristics of principles

Legend
- Components and Principles are requirements for an effective system of internal control
- Points of Focus and Controls are subject to management judgment
2013 Framework articulates seventeen principles for effective internal control

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

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

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

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

16. Conducts ongoing and/or separate evaluations
17. Evaluates and communicates deficiencies
2013 Framework clarifies requirements for an effective system of internal control

An effective system of internal control requires:
- Each of the five components of internal control and relevant principles is present and functioning
- The five components are operating together in an integrated manner

*Components are present and functioning* if each relevant principles is determined to be present and functioning (e.g., no material weakness exists)

*Relevant principles are present and functioning* if persuasive evidence exists that controls are selected, developed and deployed to effect them

*Components operate together* when:
- Components are present and functioning
- Internal control deficiencies aggregated across components do not result in the determination that one or more material weakness exist
2013 Framework describes points of focus for each principle, e.g.,

**Component**

**Principles**

**Control Environment**

- **Principle 1** Demonstrates Commitment to Integrity...
- **Principle 2** Exercises Oversight Responsibility
- **Principle 3** Establishes Structures Authority,...
- **Principle 4** Demonstrates Commitment to Competence

**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**
- **Establishes oversight responsibility**
- **Applies relevant expertise**
- **Operate independently**
- **Provides oversight for the system of internal control**
- **Considers all structures of the entity**
- **Establishes reporting lines**
- **Defines, assigns and limits authorities and responsibilities**
- **Establishes policies and practices**
- **Evaluates competence and addresses shortcomings**
- **Attracts, develops, and retains individuals**
- **Plans and prepares for succession**
Points of focus describe important characteristics of the principles, for example...

Component

Risk Assessment

Principles

Principle 6
Specifies suitable objectives

Principle 7
Identifies and analyzes risk

Principle 8
Assesses fraud risk

Principle 9
Identifies and analyzes significant change

Points of Focus

• Complies with applicable accounting standards
• Considers materiality
• Reflects entity activities

• Includes entity, division, operating unit, and functions
• Analyzes internal / external factors
• Involves appropriate level of management
• Estimates significance of risks identified
• Determines how to respond to risks

• Considers various types of fraud
• Assesses incentive and pressures
• Assesses opportunities
• Assesses attitudes and rationalizations

• Assesses changes in external environment
• Assesses changes in business model
• Assesses changes in leadership
Transitioning ICFR to 2013 Framework
Transitioning ICFR to 2013 Framework

- COSO decided to supersede the 1992 Framework at the end of the transition period (i.e., December 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 in the future. However, at this time, I’ll simply refer users of the COSO framework to the statements COSO has made about their new framework and their thoughts about transition.”
  (Paul Beswick, S.E.C. Chief Accountant)

- The SEC staff indicated more recently that 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 to use a suitable, recognized framework, particularly after December 15, 2014 when COSO will consider the 1992 framework to have been superseded by the 2013 framework.
  (Center for Audit Quality's SEC Regulations Committee)
Transitioning ICFR to 2013 Framework – A 404 transition timeline

Phase 1: Educate and Communicate
Phase 2: Conduct Preliminary Assessment
Phase 3: Complete Assessment & Develop Action Plan
Phase 4: Execute Action Plan

Timeline:
- May '13
- Q2
- Q3
- Q4
- Q1
- Q2
- Q3
- 12/31/14
# A 404 transition plan (example)

<table>
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<tr>
<th>Four-phases</th>
<th>Key Actions</th>
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| **Phase 1: Educate and Communicate** | • Review *2013 Framework* and illustrative tools  
• Conduct training appropriate for board/committee members, senior management, managers, etc.  
• Develop understanding of where principles are relevant at the entity (i.e., corporate) and subunits (divisions, subsidiaries, operating units and functional levels) |
| **Phase 2: Conduct Preliminary Assessment** | • Map 17 principles (considering points of focus) to entity level controls (ELCs)  
• Consider whether differences in controls exist at subunits  
• Identify any significant “gaps” in design or SOX documentation of controls (i.e., assess whether each component of internal control and principle is “present”) |
| **Phase 3: Complete Assessment & Develop Action Plan** | • Perform comprehensive assessment and assess the operating effectiveness of controls (i.e., assess whether each component of internal control and principle is “functioning”)  
• Assess severity of any internal control deficiencies  
• Identify changes in controls or SOX documentation necessary to remediate deficiencies |
| **Phase 4: Execute Action Plan**     | • Remediate internal control deficiencies of SOX documentation, as needed |
Reactions and responses will differ depending on circumstances.

If 1992 Framework has been thoroughly applied to current ICFR, the transition should not result in significant changes or incremental effort.

Preliminary assessment (i.e., mapping principles, considering points of focus, to controls) may reveal “gaps” in design or documentation of some controls:

- **Design**—Controls are not designed to demonstrate a principle is present.
- **Documentation**—Controls associated with the principle exist, but they are not included in the SOX internal control documentation.

Focus on design of *indirect entity level controls* (ELCs) that affect the 14 principles associated with the “softer” components of internal control. Indirect ELCs have an important, but indirect, effect on the likelihood that a misstatement will be detected or prevented on a timely basis.

No impact expected on design of *direct ELCs* and *transaction level controls* (e.g., three way match, cash reconciliation) relating to Control Activities.
Potential impact on ICFR

- ELCs operate throughout the entire organization and often have a pervasive impact on controls. For example, the design of an indirect ELC focused on assessing financial reporting risks can be conducted at the corporate level to assess risks relating to all components of the entity (i.e., subunit locations) or at individual components.

- Determining whether a principle is present is a matter of management judgment. Assessing the design of ELCs include:
  - Component(s) of the entity covered by the control being evaluated
  - Objective of the control
  - Who performs the control with necessary authority and competence
  - Frequency of the control's operation
  - Specific procedures that are performed to meet the stated objective, including any information used in the operation of the control

- By taking a fresh look at the design of indirect ELCs, management may identify opportunities to re-design controls to enhance effectiveness or efficiency.
**Potential Impact on ICFR**

- Evaluation of the three principles related to the Control Activities component should be focused on the process for selecting, developing and deploying control activities rather than the detailed control activities themselves.

  - Therefore, transitioning to the 2013 Framework will not result in any changes to a company’s risk and control matrices relating to transaction controls (e.g., three way match, cash reconciliations, etc.).

- Refer to the 2013 Framework for definitions or descriptions of key terms and phrases (e.g., components, principles, points of focus, present and functioning, operating together, etc.)

- The mapping of principles to controls will ultimately support the company’s design of the “soft” components of internal control over financial reporting in accordance with the 2013 Framework
When do you anticipate getting started with transitioning ICFR to 2013 Framework?

A. Now  
B. By end of calendar 2013  
C. In first half of 2014  
D. In second half of 2014  
E. Don’t yet know
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