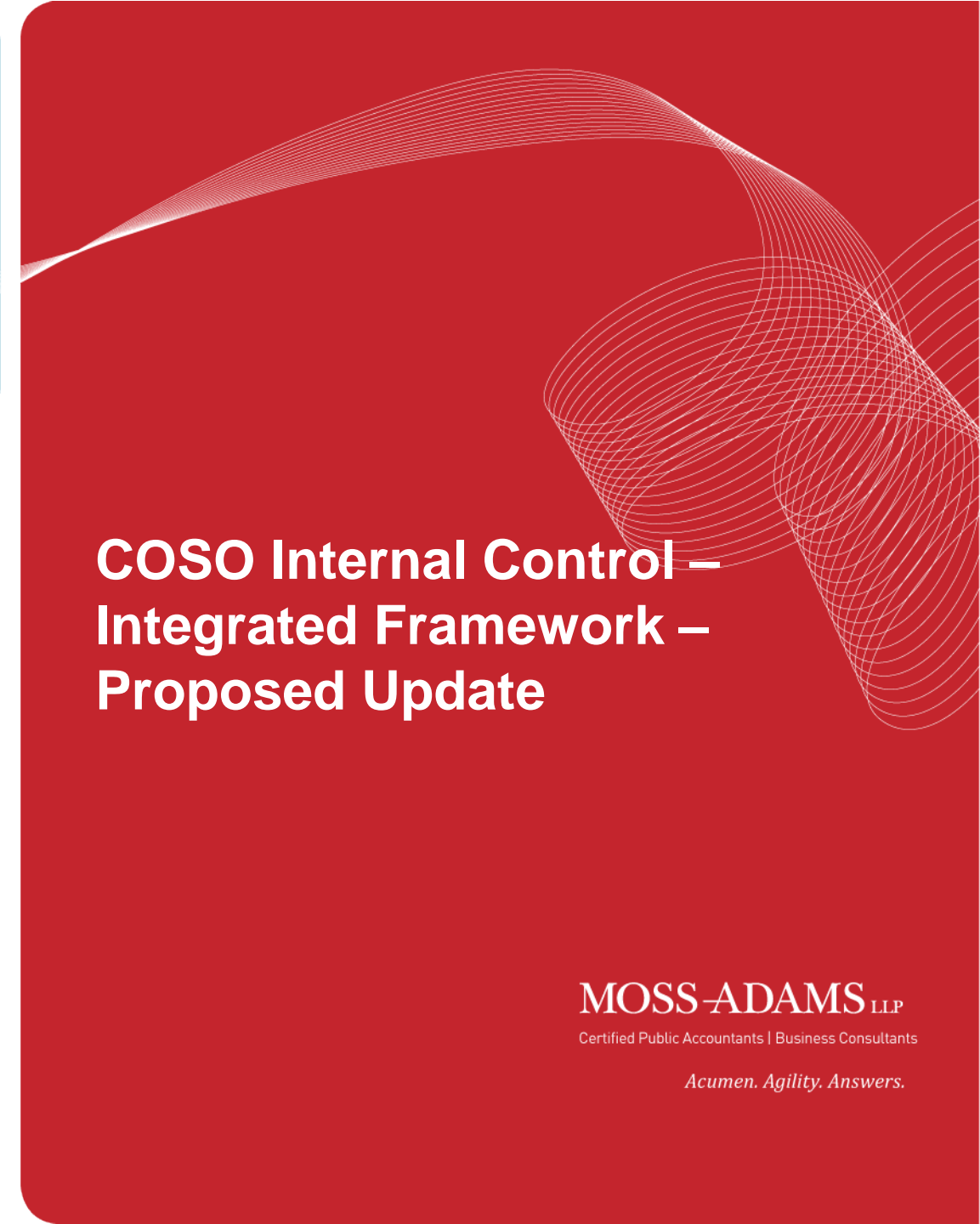


# COSO Internal Control – Integrated Framework – Proposed Update



Presented by: Dustin Birashk

September 20, 2012

**MOSS ADAMS** LLP

Certified Public Accountants | Business Consultants

*Acumen. Agility. Answers.*

# DISCLOSURE STATEMENT

The material appearing in this presentation is for informational purposes only and is not legal or accounting advice. Communication of this information is not intended to create, and receipt does not constitute, a legal relationship, including, but not limited to, an accountant-client relationship. Although these materials may have been prepared by professionals, they should not be used as a substitute for professional services. If legal, accounting, or other professional advice is required, the services of a professional should be sought.

# ABOUT MOSS ADAMS LLP



- Full-service public accounting firm with assurance, tax, and consulting services for middle-market public and private companies
- One of the 15 largest accounting firms in the U.S. and largest firm headquartered on the West Coast
- 22 offices in Arizona, California, Kansas, New Mexico, Oregon, and Washington
- Founded in 1913 and headquartered in Seattle, Washington
- Founding member of Praxity, a global alliance of accounting firms

# PRESENTER



## **Dustin Birashk, CPA**

Dustin has been in public accounting since 1999 and specializes in audits of financial institutions and financial services companies. Dustin is proficient in serving financial institutions. He is actively involved in the firm's Financial Services Group and is a frequent speaker at the firm's annual conferences and Moss Adams-hosted webinars, and authors articles for *MA Now* and industry publications. Dustin received his BA in Business Administration from the University of Washington, and completes continuing education annually. He is a member of the Washington Society of Certified Public Accountants and the American Institute of Certified Public Accountants.

# WHAT I DO WHEN I'M NOT COUNTING BEANS



# PRESENTATION OBJECTIVES

- Providing context
- Understanding why COSO is updating the framework
- Noting the key changes
- Reviewing the new proposed principles and points of focus
- Reviewing the timeline for the final framework and the current status



# PRESENTATION OBJECTIVES

- Assuming that most of the revised framework stays the same, how might this impact your organization?
- How might this impact the way auditors approach your organization?
- What you can do to effect change?

# COSO FRAMEWORK

- Who is familiar with the original COSO Framework from 1992?





## PROVIDING SOME CONTEXT

- Article on the downfall of Washington Mutual as a backdrop for our discussion today
- Take a few minutes to read the article provided about the reasons for the collapse of Washington Mutual and identify/highlight some of the key control failures noted throughout the article

## WHY THE CHANGE?

- COSO set out to update its nearly 20-year-old framework for new technology demands and capabilities, in addition to globalization
- Updated framework doesn't change core objectives or definitions, but specifies 17 guiding principles divided among the 5 components of internal control
- COSO believes that the updates will result in a more flexible, reliable, and cost-effective approach to controls

# WHY THE CHANGE?

- COSO chair calls the updated framework a “refresh”
- Context is changed to recognize the current environment compared with 1992
  - Governance much more important
  - Audit committees more important
  - Compensation committees more important
  - Technology is much different. No internet or prevalent email in 1992
  - Business models have changed – more complex
    - Joint ventures
    - Outsourcing

## WHY THE CHANGE?

- COSO is also issuing new guidance in the form of the Internal Control Over External Financial Reporting Approaches and Examples
  - Exposure draft expected late 2012 or early 2013
  - The focus of this will be to focus on internal controls specific to financial reporting objectives
  - “Hot of the press” update next slide
- Regulators were involved in this initiative
  - Representatives from the FDIC, GAO, IFAC, PCAOB, and SEC were invited as observers

## HOT OF THE PRESS!

- COSO released their updated version of the proposed Internal Control – Integrated Framework on September 18.
- COSO also released their exposure draft of *Internal Control over External Financial Reporting: A Compendium*
- The comment period for both items above ends November 20, 2012

# WHAT ARE THE MAJOR CHANGES IN THE PROPOSED REFRESH?

- Adoption of a principles and points of focus approach in the framework to provide more detailed guidance for designing and assessing the effectiveness of internal control
- Clarifies the role of objective setting
- Reflects the increased relevance of technology
- Enhances governance concepts
- Recognizes that reporting extends far beyond just financial reporting
- Emphasizes the importance of compliance and operations objectives

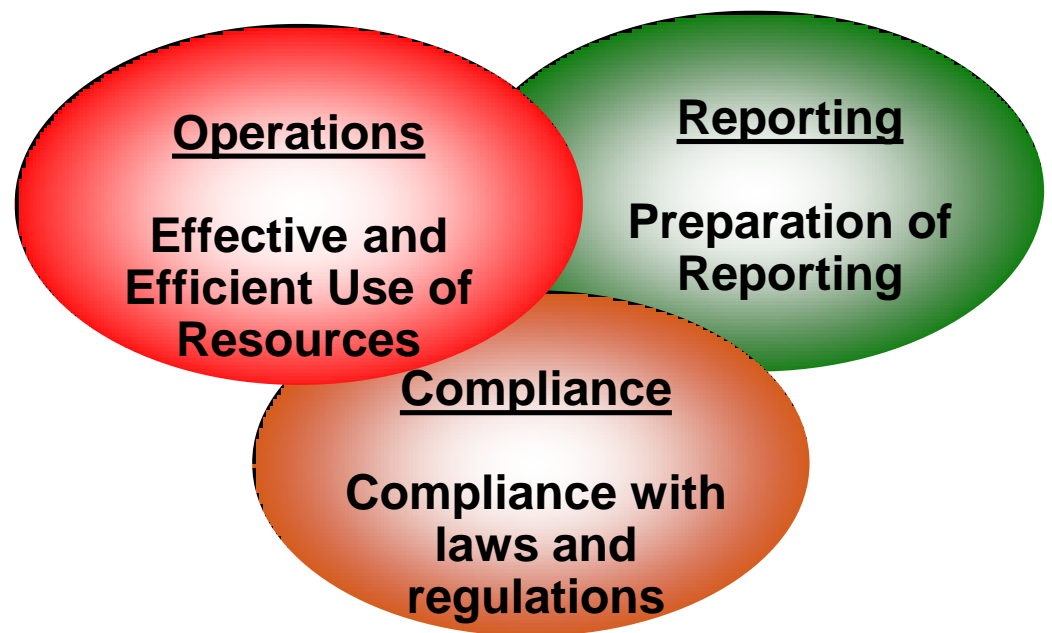
# WHAT ARE THE MAJOR CHANGES IN THE PROPOSED REFRESH?

- Enhances consideration of anti-fraud expectations
- More recognition that operations, compliance, reporting, and the need for internal control often cross boundaries of organizations and countries
- More detailed guidance of alternative ways in which an organization might implement a component of internal control and thus accomplish effective internal control
- Considers different business models and organizational structures
- Other changes at the component level that will be discussed later



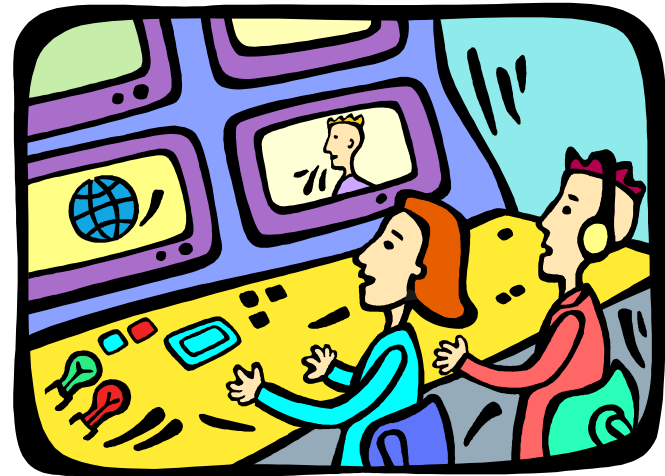
# WHAT ARE INTERNAL CONTROLS? NO CHANGE TO THE DEFINITION OF INTERNAL CONTROL

- Internal controls are policies and procedures that an entity puts in place to help ensure the entity meets its goals and objectives
- Controls relate to these areas:



# 17 NEW PRINCIPLES

- Control Environment – 5 principles
- Risk Assessment – 4 principles
- Control Activities – 3 principles
- Information and Communication – 3 principles
- Monitoring Activities – 2 principles



# CONTROL ENVIRONMENT

- Commitment to integrity and ethics
- Oversight for internal control by the board of directors, independent of management
- Structures, reporting lines, and appropriate responsibilities in the pursuit of objectives established by management and overseen by the board
- A commitment to attract, develop, and retain competent individuals in alignment with objectives
- Holding individuals accountable for their internal control responsibilities in pursuit of objectives

# COMMITMENT TO INTEGRITY AND ETHICS

- Board and management set the tone at the top
- Establishment of standards of conduct
- Evaluation of adherence to standards of conduct
- Address deviations in a timely manner

# OVERSIGHT BY INDEPENDENT BOARD

- Establish Board of Directors oversight responsibilities
- Board retains or delegates oversight responsibilities
- Board applies relevant expertise
- Board operates independently
- Board guides, directs, and reviews the development and performance of the system of internal control



# ESTABLISHES STRUCTURE, AUTHORITY, AND RESPONSIBILITY

- Considers all structures of the entity (operating units, legal entities, outsourced service providers)
- Establishes reporting lines
- Defines, assigns, and limits authorities and responsibilities

# DEMONSTRATES COMMITMENT TO COMPETENCE

- Establishes policies and procedures
- Attracts, develops, and retains individuals
- Evaluates competence and addresses shortcomings
- Plans and prepares for succession



# ENFORCES ACCOUNTABILITY

- Enforces accountability through structures, authorities, and responsibilities
- Establishes performance measures, incentives, and rewards
- Evaluates performance measures, incentives, and rewards for ongoing relevance
- Considers excessive pressures
- Evaluates performance and rewards or disciplines individuals

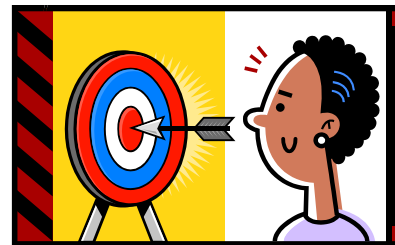
# RISK ASSESSMENT

- Specifying objectives clearly enough for risks to be identified and assessed
- Identifying and analyzing risks to determine how they should be managed
- Considering the potential of fraud
- Identifying and assessing changes that could significantly impact the system of internal control



# SPECIFYING CLEAR OBJECTIVES

- Considers tolerance for risk
- Reflects management's choices (structure, industry concentrations, etc.)
- Includes operations and financial performance goals
- Forms basis for committing of resources
- Complies with externally established standards, laws, and regulations
- Reflects the entity's activities



# IDENTIFIES AND ANALYZES RISKS

- Involves appropriate levels and management
- Includes entity, subsidiary, division, operating unit, and functional level – consider CUSOs
- Analyzes internal and external factors
- Estimates significance of risks identified
- Determines how to respond to risks

# ASSESSES FRAUD RISK

- Considers various ways that fraud can occur
- Considers fraud risk factors
- Assesses incentives and pressures
- Assesses opportunities
- Assesses attitudes and rationalizations



# IDENTIFIES AND ANALYZES SIGNIFICANT CHANGE

- Assesses changes in the external environment
- Assesses changes in the business model
- Assesses changes in leadership

# CONTROL ACTIVITIES

- Selecting and developing controls that help mitigate risks to an acceptable level
- Selecting and developing general control activities over technology
- Deploying control activities as specified in policies and relevant procedures





# SELECTING AND DEVELOPING CONTROL ACTIVITIES

- Integrates with risk assessment
- Determines relevant business processes
- Considers entity-specific factors
- Evaluates a mix of control activity types
- Considers at what level activities are applied
- Addresses segregation of duties



# SELECTS AND DEVELOPS GENERAL CONTROLS OVER TECHNOLOGY

- Determines dependency between the use of technology in business processes and technology general controls
- Establishes relevant technology infrastructure control activities
- Establishes relevant security management process control activities
- Establishes relevant technology acquisition, development, and maintenance process control activities

# DEPLOYS THROUGH POLICIES AND PROCEDURES

- Establishes policies and procedures to support deployment of management's directives
- Establishes responsibility and accountability for executing policies and procedures
- Performs using competent personnel
- Performs in a timely manner
- Takes corrective action
- Reassesses policies and procedures



# INFORMATION AND COMMUNICATION

- Obtaining or generating relevant, high-quality information to support internal control
- Internally communicating information, including objectives and responsibilities, necessary to support the other components of internal control
- Communicating relevant internal control matters to external parties

# USES RELEVANT INFORMATION

- Identifies information requirements
- Captures internal and external sources of data
- Processes relevant data into information
- Maintains quality throughout processing
- Considers costs and benefits



# COMMUNICATES INTERNALLY

- Communicates internal control information with personnel
- Communicates with the Board of Directors
- Provides separate communication lines
- Selects relevant method of communication



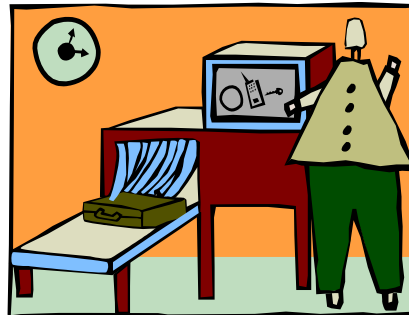
# COMMUNICATES EXTERNALLY

- Communicates to external parties
- Enables inbound communications
- Provides separate communication lines (think whistleblower)
- Communicates with the Board of Directors
- Selects relevant method of communication



# MONITORING ACTIVITIES

- Selecting, developing and performing ongoing or separate evaluations of the components of internal control
- Evaluating and communicating deficiencies to those responsible for corrective action, including senior management and the Board of Directors, where appropriate



# CONDUCTS ONGOING AND/OR SEPARATE EVALUATIONS

- Considers a mix of ongoing and separate evaluations
- Establishes baseline understanding
- Considers rate of change
- Uses knowledgeable personnel
- Integrates with business processes
- Objectively evaluates
- Adjusts scope and frequency

# EVALUATES AND COMMUNICATES DEFICIENCIES

- Assesses results
- Communicates deficiencies to management
- Reports deficiencies to senior management and the Board of Directors
- Monitors corrective actions

## FROM THE COSO BOARD

- What will preparers need to do differently under the updated framework?
  - Continue to look at their control structure and see if it lines up with the updated framework
  - May be some slight nuances and changes to make in order to line up with the 17 new principles, and in some cases some additional testing

# FROM THE COSO BOARD

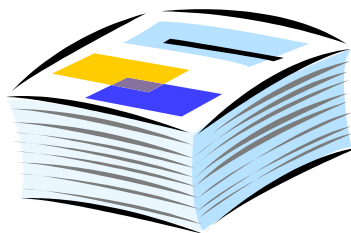
- What will boards and committees need to do differently?
  - Understand that internal control is not simply a compliance activity
  - Internal control is about achieving business and other objectives in an efficient and effective manner
  - May not just be financial reporting items
  - Think in terms of all of the 17 new principles

## FROM THE COSO BOARD

- What will auditors need to do differently under the updated framework?
  - Attestation standards and their language may need to adapt to the new principles
  - Approach may need to be modified to ensure it aligns with new principles

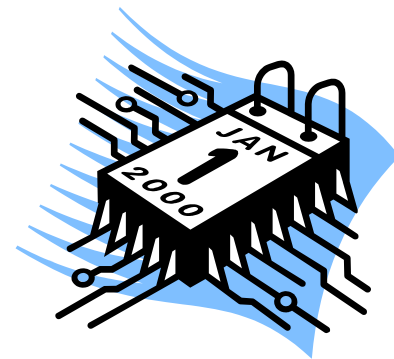
# WHY HAS THE REPORTING OBJECTIVE CHANGED?

- Reporting still encompasses financial reporting, but it now also encompasses nonfinancial reporting
- Covers both internal and external reporting
- There is a significant increase in reporting beyond just the numbers, and controls need to cover all aspects of reporting



# TIMELINE

- Originally, COSO expected to release the updated framework in late 2012.
- Based on the amount of comments and feedback on the exposure draft, and concerns about possible implications for 2012 reporting, the release of the updated framework is expected in the first quarter of 2013.





# TIMELINE

- How much feedback was received?
  - 97 comment letters
  - More than 100 responses to the online survey
  - Hundreds of additional ideas for consideration
- How does this impact you?
  - Parts of the updated framework will change from the exposure draft
  - Important to understand the exposure draft, but not go too far down the path of making any changes



# SUMMARY OF REVISIONS IN REVISED DRAFT ISSUED SEPTEMBER 18, 2012

\* OBTAINED FROM COSO POWERPOINT PRESENTATION FROM COSO WEBSITE



## Public exposure of updated Framework: Summary of revisions arising from comment letters

- Definition of Internal Control
  - Removes modifiers (e.g., reliable financial reporting) from categories of objectives
- Assessing Effectiveness
  - Clarifies that effective internal control requires (i) each of the five components and relevant principles are present and functioning and (ii) the five components are operating together
  - Modifies classification of internal control deficiencies into two tiers: (i) major deficiency, which precludes effective internal control, and (ii) internal control deficiency
  - Clarifies that points of focus (formerly attributes) are important considerations in determining whether a principle is present and functioning
  - Removes presumption that points of focus are present and functioning, and clarifies use of judgment in identifying and considering relevant points of focus
- Principles
  - Clarifies descriptions of several principles

# SUMMARY OF OTHER CONSIDERATIONS BASED ON COMMENT LETTERS

\* OBTAINED FROM COSO POWERPOINT PRESENTATION FROM COSO WEBSITE



## Public exposure of updated Framework: Summary of other considerations arising from comment letters

- Objective Setting
  - Retains five components of internal control
  - Retains view that specifying objectives is part of internal control but establishing objectives is not
- Objectives
  - Retains operations, reporting, and compliance objective categories, and expands descriptions
  - Retains view that safeguarding of assets primarily relates to operations objectives, and recognize its consideration within reporting and compliance
  - Retains view that strategic objectives is not part of internal control
- Structure and Layout
  - Retains view that the Framework comprises all chapters

# SUMMARY OF OTHER CONSIDERATIONS BASED ON COMMENT LETTERS

\* OBTAINED FROM COSO POWERPOINT PRESENTATION FROM COSO WEBSITE



## Public exposure of updated Framework: Summary of other considerations arising from comment letters (continued)

- Enterprise Risk Management (ERM)
  - Retains distinction between ERM and Internal Control
  - Retains view that strategy-setting, strategic objectives, and risk appetite are aspects of ERM and not part of the updated Framework
  - Retains definition of risk appetite and application of risk tolerance
- Smaller Entities and Governments
  - Includes excerpts from COSO's Guidance for Smaller Public Entities (Appendix C)
  - Appendix C includes considerations relevant for smaller entities
- Technology
  - Expands discussion in the points of focus and in several chapters
  - Excludes discussion on specific technologies and associated risks due to rapid pace of change of technology

# OVERVIEW OF EXAMPLE TOOLS FOR INTERNAL CONTROL

\* OBTAINED FROM COSO POWERPOINT PRESENTATION FROM COSO WEBSITE



## Overview of Illustrative Tools for Assessing Effectiveness of a System of Internal Control

- Tools include collection of Templates and Scenarios that can assist users when assessing the effectiveness of a system of internal control based on the requirements set forth in the updated Framework
- Templates help management present a summary of assessment results and its determination of whether components and principles are present and functioning
- Scenarios illustrate how Templates can be used to support an assessment of effectiveness of a system of internal control, including:
  - Is a component and relevant principles present and functioning?
  - Are the five components present, functioning and operating together in an integrated manner?
- Illustrative Tools do not replace or modify the updated Framework

# ICEFR COMPENDIUM – EXPOSURE DRAFT ISSUED SEPTEMBER 18, 2012

- Types of financial reports
- Suitable objectives
- Judgment
- Overlapping objectives
- Deficiencies in internal control
- Smaller entities
- Approaches and examples



WHAT'S MORE FUN THAN LISTENING TO A PRESENTATION ON INTERNAL CONTROLS? RIDING IN A WAGON, OF COURSE!





THANK YOU

Presented by: Dustin Birashk

September 20, 2012



# COSO Internal Control – Integrated Framework – Proposed Update

**MOSS ADAMS** LLP

Certified Public Accountants | Business Consultants

*Acumen. Agility. Answers.*