

COSO Framework Update State of Maine

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Assurance • Tax • Consulting

Today's presenters



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Agenda

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COSO background

COSO overview



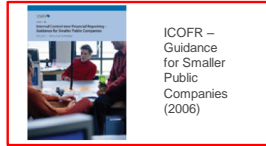
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- The Committee of Sponsoring Organizations of the Treadway Commission (COSO) is a joint initiative of five sponsoring organizations formed in 1985
- Provides thought leadership through the development of frameworks and guidance on:
 - Internal control
 - Enterprise risk management
 - Fraud
- Designed to improve organizational performance and governance, and to reduce the extent of fraud in organizations
- Released original *Internal Control-Integrated Framework* in 1992 which has become the most widely used control framework used in management's SOX assertion

Select COSO frameworks



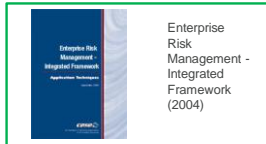
Internal Control – Integrated Framework (2013)



ICFR – Guidance for Smaller Public Companies (2006)



Internal Control – Integrated Framework (1992)



Enterprise Risk Management - Integrated Framework (2004)

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The update process

The update process

- Why is the COSO Framework being updated?
 - The existing framework was issued in 1992
 - Updated to remain relevant and useful
- This is a “refresh” not a “start over”.
 - Principles based
 - Increased guidance and examples



Overview of what is and is not changing

Update expected to increase ease of use and broaden 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...

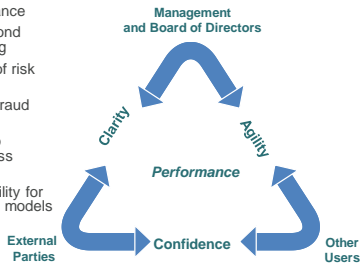
- Changes in business and operating environments considered
- Operations and reporting objectives expanded
- Fundamental concepts underlying five components articulated as principles with points of focus as additional guidance
- Additional approaches and examples relevant to operations, compliance, and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



Slide Source: COSO IC:IF Outreach Deck, 12.29.11
<http://www.ciso.org/pages/about-the-project.aspx>

Intended benefits of updated Framework

- Improve governance
- Expand use beyond financial reporting
- Improve quality of risk assessment
- Strengthen anti-fraud efforts
- Adapt controls to changing business needs
- Greater applicability for various business models



Slide Source: COSO IC:IF Outreach Deck, 12/29/11
<http://www.ic.coso.org/page/about-the-project.aspx>

Transition

- Updated Framework was issued May 14, 2013
- COSO will continue to make available the original framework during the transition period extending to December 15, 2014, after which time COSO will consider it as having been superseded
- Early adoption is permitted
- Updated Framework supersedes existing Framework and *Internal Control over Financial Reporting – Guidance for Smaller Public Companies*



The 17 principles and changes to the 5 components

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



Internal control principles

Control Environment	<ol style="list-style-type: none"> 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	<ol style="list-style-type: none"> 6. Specifies suitable objectives 7. Identifies and analyzes risk 8. Assesses fraud risk 9. Identifies and analyzes significant change
Control Activities	<ol style="list-style-type: none"> 10. Selects and develops control activities 11. Selects and develops general controls over technology 12. Deploys through policies and procedures
Information & Communication	<ol style="list-style-type: none"> 13. Uses relevant information 14. Communicates internally 15. Communicates externally
Monitoring Activities	<ol style="list-style-type: none"> 16. Conducts ongoing and/or separate evaluations 17. Evaluates and communicates deficiencies



Slide Source: COSO IC-F Outreach Deck, 12/29/11
(<http://www.ic.cso.org/pages/about-the-project.aspx>)

Control environment

Control environment

The set of standards, processes, and structures that provide the basis for carrying out internal control across the organization.



Newly defined principles

1. The organization demonstrates a commitment to integrity and ethical values.
2. The board of directors demonstrates independence of 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.

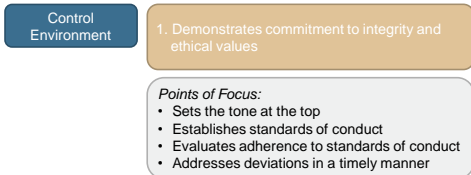


Control environment – changes

- Five principles outline what is commonly called the “tone at the top”
- Expanded discussion and consideration of governance roles and notion of risk oversight
- Includes considerations for internal control in complex business environments
 - Outsourced service providers
 - Business partners
 - External partners



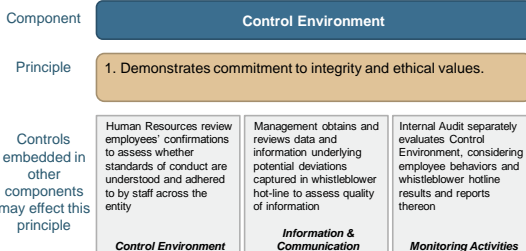
Example principle and related points of focus



- Points of focus are typically important characteristics of principles that can be used to facilitate designing, implementing, and conducting internal control
- There is no requirement to separately assess whether points of focus are in place
- 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



Example of controls embedded in other internal control components



Risk assessment

Risk assessment

A dynamic and iterative process for identifying and assessing risk to the achievement of objectives.



Newly defined principles

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.



Risk assessment – changes

- Principle specifically focused on consideration of fraud
- Clarifying risk assessment includes
 - Risk identification
 - Risk analysis
 - Risk response
- Expands discussion on management’s need to understand changes in internal and external factors



Control activities

Control activities

The actions established through policies and procedures that help ensure that management’s directives to mitigate risks to the achievement of objectives are carried out.



Newly defined principles

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 action.



Control activities – changes

- Broadening discussion of technology
- Expanded discussion of automated control activities and general controls over technology
- Clarifies that control activities are actions established by policies and procedures not the policies and procedures themselves



Information and communication

Information and communication

Communication is the continual, iterative process of providing, sharing, and obtaining necessary information. Internal communication is the means by which information is disseminated throughout the organization. External communication enables inbound communication and provides external information.



Newly defined principles

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 internal control.
15. The organization communicates with external parties regarding matters affecting the functioning of internal control.



Information and communication – changes

- Emphasizes importance of quality of information
- Expands on reliability and protection of information
- Reflects impacts of technology on speed, means, and quality of flow of information
- Emphasizes importance of communication outside the entity (such as third-party service providers)



Monitoring activities

Monitoring activities

Ongoing evaluations, separate evaluations, or some combination of the two used to ascertain whether each of the five components of internal control are present and functioning.



Newly defined principles

- 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.



Monitoring activities - changes

- Clarifies that monitoring activities apply to all components of the Framework, not only control activities
- Includes two main categories of monitoring activities
 - Ongoing evaluations
 - Separate evaluations
- Expands discussion of technology and external service providers



Scalability

- Appendix C of the Framework provides considerations for smaller entities and governments
- Key consideration factors are provided for:
 - Segregation of duties
 - Management override
 - Board of directors
 - Information technology
 - Monitoring activities

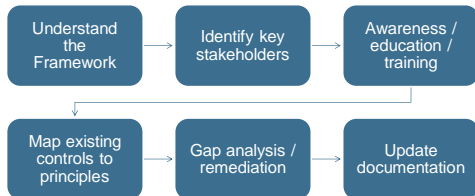


The implementation process

Impact of adopting the updated Framework

- Initial level of effort will vary by organization depending on their existing level of documentation, stakeholder involvement and locations
- Provides flexibility in applying the Framework to multiple, overlapping objectives across the entity
 - Easier to see what is covered and what is missing
 - May reduce likelihood of considering controls that are irrelevant
 - May reduce the number of discrete risks assessed and mitigated
- Potential for initial deficiencies if the system of internal control does not address each of the principles
- Heightened focus on entity-wide controls provides a platform for addressing increased entity-level scrutiny from authoritative bodies (e.g. SEC, PCAOB, AICPA)

Steps for implementing 2013 Framework



Timing considerations

- Updated Framework will supersede original Framework on December 15, 2014
- Earlier implementation encourage
- During the transition external reporting should disclose which version of the Framework was used

Conclusion

Resources

- McGladrey Whitepaper, *An Overview of COSO's 2013 Internal Control-Integrated Framework*
<http://mcgladrey.com/Insights/2013-COSO-Framework-Update-webcast-and-whitepaper>
- COSO Resources
 - *Internal Control-Integrated Framework*
 - Executive summary
 - Framework and Appendices
 - Illustrative tools for assessing effectiveness of a system of internal control
 - *Internal Control over External Financial Reporting, a Compendium of Approaches and Examples*
www.coso.org




Questions?

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