The Committee of Sponsoring Organizations of the Treadway Commission

COSO's ICIF Update

Discussion with PCAOB's Standing Advisory Group

March 24, 2011

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Agenda

- **Overview of COSO**
- ICIF Project Objectives, Governance and Timetable
- Areas of Update and Overall Document Structure
- Impact Envisioned on Governance Principles, Fraud Deterrence, and SOX 404, including Transition

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About COSO

- Formed in 1985 to sponsor the National Commission on Fraudulent Financial Reporting (i.e. the Treadway Commission)
- A voluntary private sector organization
- Sponsors:
  - American Accounting Association (AAA)
  - American Institute of Certified Public Accountants (AICPA)
  - Financial Executives International (FEI)
  - Institute of Management Accountants (IMA)
  - The Institute of Internal Auditors (IIA)

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Board Members

- David L. Landsittel – Chairman
- Larry E. Rittenberg – Chairman Emeritus
- Mark S. Beasley – AAA
- Charles E. Landes – AICPA
- Marie N. Hollein – FEI
- Jeffrey C. Thomson – IMA
- Richard F. Chambers – IIA

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Mission

*"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."*

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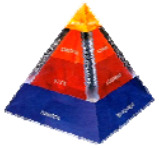
Timeline

1987: Treadway Commission Report

1992: Internal Control Framework



1996: Internal Control Issues in Derivatives

1999: Fraud Study I - Fraudulent Financial Reporting: 1987-1997

2004: Enterprise Risk Management Framework

2006: Guidance for Smaller Businesses on Internal Control over Financial Reporting

2009: Guidance on Monitoring Internal Control Systems

2010: Fraud Study II - Fraudulent Financial Reporting: 1998-2007

2010: Recent thought papers on current issues

1985 1990 1995 2000 2005 2010

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COSO ICIF Project Objectives

- The overall goal of the project is to update the ICIF Framework originally published in 1992
- Enhancements are not intended to alter the five core components first developed in the original Framework
- However, there may be changes pertaining to the application of these components that could impact how organizations:
  - Design, implement, and test internal controls
  - Report to regulators (e.g., SOX 404)
- The updated Framework will be of relevance to auditors as well as management
- Relevance of the Framework around the globe is intended to be maintained, if not increased

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Project Roles & Responsibilities

COSO Board

- Provide overall ownership of the project
- Nominate the Advisory Council Members
- Oversee PwC and make final decisions on the issues that emerge
- Oversee advisory council, regulatory and other stakeholder dialogue

PwC Project Team

- Manage project execution
- Gather input from stakeholders
- Prepare draft update for public exposure
- Collect and review public comments and draft final documents

Advisory Council

- Serve as a sounding board on ICIF issues arising during input gathering, drafting and exposure stages
- Establish a process for obtaining and synthesizing input from respective sponsoring organization
- Review and comment on draft deliverables

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Overview of Project Plan & Timetable

Assess and Envision → Design & Build → Public Exposure → Finalize

2010 | 2011 | 2012

Sept – Jan	Feb - Aug	Sept - Dec	Jan - June
✓Develop vision and strategy for update ✓Conduct research and identify preliminary areas for update and rationale ✓Develop project plan ✓Develop, test, and launch survey questions	✓Analyze and discuss survey results ✓Engage PwC extended team, Advisory Council and other organizations for input • Revise existing content and create new • Vetting of the revised content by the COSO Board	• Develop process for collection of public comments • Summarize nature of updates to project stakeholders • Issue public exposure communications and follow-up	• Collect and process public comments • Confirm significant revisions with COSO Board • Finalize document • Copy editing and publication

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Overview of Survey Results

- 653 responses as of Jan 31, 2011; over 700 responses to date
- Responses come from wide range of organizations and individuals
  - Large, small and non-profit organizations well represented
  - 1 in 4 respondents are international (27%)
  - The majority of respondents have been using the Framework for over 5 years
- Overall, a large majority of respondents support updating, but not a major overhaul in the Framework

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Areas of Update Envisioned

Key Themes from All Sources	Who Said It		
	Advisory Council Discussion	Survey Responses	Offline Comments
1. Reflect implication of increased use of technology and greater complexity of operational environment	✓	✓	✓
2. Incorporate lessons learned from SOX and cost / benefit considerations		✓	
3. Capture increased ethics, compliance and anti-fraud expectations	✓	✓	✓
4. Broaden the scope of reporting beyond external financial reporting	✓	✓	✓
5. Enhance the concept of risk oversight and role of risk assessment	✓	✓	✓
6. Expand on governance roles in organizations	✓	✓	✓
7. Demonstrate more clearly the linkages between the Framework components		✓	

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Areas of Update Envisioned (cont.)

Key Themes from All Sources	Who Said It		
	Advisory Council Discussion	Survey Responses	Offline Comments
8. Clarify and simplify language	✓	✓	✓
9. Apply a more principles-based approach and provide basis for evaluating deficiencies	✓	✓	✓
10. Maintain definition of internal control		✓	✓
11. Increase practical guidance to supplement the conceptual framework		✓	✓
12. Balance discussion of financial reporting with operations and compliance	✓		
13. Discuss performance management and incentives	✓		
14. Reduce US-centric perception of the Framework	✓		✓

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Document Structure

- Two Products Contemplated:
  (1) A revised overall Framework encompassing (a) Reporting, (b) Operational and (c) Compliance objectives
  (2) A companion document focusing on application of the Framework to Financial Reporting Objectives (e.g. SOX 404)
- A focus on 20+ "Principles" drawn from the five components of the Framework
  - It is generally expected that all principles will, to some extent, be present and functioning for a organization to have effective internal control
  - When a principle is not being met, some form of internal control deficiency exists
- "Attributes" representing characteristics associated with the principles

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Impact on Governance

- Will enhance the notion of governance as the concept pervades organizations more broadly than as defined or inferred in the original Framework
- Will incorporate lessons learned from root causes of failures in corporate governance of recent years
- Will make more robust the discussion of "Tone at the Top"

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Impact on Fraud Deterrence

- Will expand discussion of safeguarding of assets to include considerations of:
  - Fraud
  - Misrepresentation of financial statements
  - Corruption

- Will incorporate anti-fraud expectations of internal control by expanding on:
  - Control environment to capture anti-fraud expectations in establishing the "Tone at the Top"
  - Risk assessment to consider potential fraud schemes
  - Control activities to address the risk of fraud
  - Information and communication to support anti-fraud program
  - Monitoring to evaluate and report any deficiencies of the anti-fraud program or occurrences of fraud

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Impact on SOX 404 Attestation and related transition issues

- Updated Framework intended to remain consistent with SEC suitability criteria
- Updated Framework will be an evolution from the original Framework
  - An appendix to the ICIF will highlight significant changes in the updated Framework as compared with the original framework
  - A companion document will assist organizations in meeting financial reporting objectives
- Greater clarity contemplated around the basis for determining significant deficiencies and material weaknesses
- COSO anticipates that regulators will provide any needed transition guidance to filers

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