



March 30, 2012

David Landsittel
Chairman
Committee of Sponsoring Organizations of the Treadway Commission
By e-mail: icif@us.pwc.com

Re: Proposed Changes to *COSO Internal Control—Integrated Framework*

Dear Mr. Landsittel,

Within organizations across the globe, many professional accountants in business are in a position of strategic or functional leadership, or are otherwise well placed to partner with other disciplines in the planning, implementation, execution, evaluation, or improvement of internal control. In addition, many professional accountants in business have a responsibility to provide objective, accurate, and timely information and analyses to support all of these activities. Therefore, the Professional Accountants in Business (PAIB) Committee of the International Federation of Accountants (IFAC) values the opportunity to comment on the Committee of Sponsoring Organizations of the Treadway Commission (COSO)'s Exposure Draft proposing changes to the 1992 *COSO Internal Control—Integrated Framework* (the IC Framework).

About IFAC and the PAIB Committee

[IFAC](#) is the global organization for the accountancy profession dedicated to serving the public interest by strengthening the profession and contributing to the development of strong international economies. The IFAC [PAIB Committee](#) provides leadership and guidance on relevant issues pertaining to professional accountants in business and the business environments in which they work.

The PAIB Committee agrees with the objective of this project as stated on [the COSO website](#): “to increase [the IC Framework’s] relevance in the increasingly complex and global business environment so that organizations worldwide can better design, implement, and assess internal control.” However, based on COSO’s own motivation for this project, as well as on the internal control failures over the 20 years since the original framework came into existence, it could be argued that a more substantive revision of various aspects of the IC Framework would further increase its relevance. In this light, the Committee has the following recommendations for further improvement.

Continue to be a thought leader

The PAIB Committee commends COSO for being one of the first and foremost thought leaders in the area of internal control, starting with the publication of the 1992 IC Framework and followed by a series of related high-quality publications. The Committee also believes that while many of the underlying concepts



of the original 1992 framework have proven themselves over time, global developments and the various financial crises in recent years certainly warranted a revision. The update is therefore timely.

The Committee believes that the revision should continue to be a product of thought leadership by COSO, free from regulatory or other restrictions as much as possible, and based on internationally acknowledged good practice. However, the Committee also recognizes the importance of preserving a relatively stable IC Framework for entities' reporting on internal control—e.g., reporting on internal control over external financial reporting based on the Sarbanes-Oxley Act of 2002 (SOX) requirements. In this respect, the Committee welcomes COSO's decision to publish additional guidance focused solely on internal control over external financial reporting. This should clear the way for thought leadership in the revision of the underlying IC Framework.

Increase integration of frameworks

IFAC's [*Global Survey on Risk Management and Internal Control*](#) (2011), with more than 600 respondents from around the globe from all types of organizations, revealed a widely held desire that risk management and internal control systems should be better integrated into organizations' overall governance, strategy, and operations. According to survey respondents, the drive to integrate risk management and internal control systems is gaining momentum, but the tools and guidance to develop and implement a genuinely integrated system do not really exist. Currently, risk management guidelines are often separate from internal control guidelines. The first step to strengthening guidance in this area, according to respondents, is to combine these separate guidelines into one integrated set. Bringing these guidelines together would help increase the general understanding that both risk management *and* internal control are integral parts of an effective governance system.

In line with these survey outcomes, the PAIB Committee recommends that COSO further integrate its IC Framework with its Enterprise Risk Management (ERM) Framework—as well as with other frameworks, standards, and guidelines on governance, risk management, and internal control from across the globe—in order for organizations to make internal control a natural part of their overall, integrated risk management and governance system. After all, in the executive summary of its 2004 ERM Framework, COSO itself writes: “While only portions of the text of *Internal Control—Integrated Framework* are reproduced in this framework, the entirety of that framework is incorporated by reference into this one.”

Further integration is an ambitious and challenging goal, but the potential benefits are large. It is up to COSO and all other organizations responsible for developing, implementing, using, and enforcing requirements and guidelines on risk management and internal control to work together to produce a globally recognized and accepted international framework that is relevant to all. IFAC and the PAIB Committee look forward to contributing to such collaborative effort.

Broaden scope of IC Framework

The PAIB Committee believes that limiting the scope of the IC Framework to reporting, operations, and compliance objectives seems arbitrary and is unhelpful to achieve effective internal control. There are other objectives/risk categories that may be more of a determinate for overall control, for example



strategic or financial market objectives/risks. In practice, many organizations need to ensure that an internal control system with a broader scope is in place.

According to IFAC's interviews with 25 key business leaders, summarized in the brochure [Integrating the Business Reporting Supply Chain](#) (2011), various financial crises in recent years have demonstrated that in some organizations—especially some financial institutions—risk management and internal control practices were flawed. According to the business leaders interviewed, these organizations did not fully comprehend the risks to which they were exposed. Before the latest string of financial crises, many organizations were overly focused on financial reporting controls. These crises highlighted the fact that many, if not most, of the risks that affected organizations derived from external circumstances.

Moving forward, risk management and related internal control systems need to encompass a wider perspective, considering that organizations are impacted by many variables, often outside their direct control. Ongoing risk management and internal control should be a key part of integrated governance at every level of an organization and across all operations. In this light, the revised IC Framework should embrace a wider perspective instead of being limited to internal control over reporting, operations, and compliance, beginning with the adoption of a broadened definition of internal control (see below).

Broaden definition of internal control

To further expand the scope of the IC Framework, the PAIB Committee proposes COSO broaden the definition of internal control (specifically mentioning the categories, and thus excluding all other categories) to a definition where:

- *Internal control is a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of the organization's objectives, for example in its strategy, operations, reporting, and compliance.*

A broader definition of internal control will not inherently exclude other areas in which internal control also plays an important role. At the same time, COSO can build guidance around the three current categories (operations, reporting, and compliance), preferably extended to include additional areas, such as the strategic objective, and also use the standard COSO cube. In addition, by starting with a more encompassing definition, COSO can then create a more specific definition for external financial reporting in the *Internal Control for External Financial Reporting* guidance document that it plans to release in conjunction with the IC Framework. The key difference in wording is that the areas mentioned are only examples and do not automatically exclude other areas.

A further enriched definition of internal control, taking into account the PAIB Committee's proposals as well as the suggestions from IFAC's [Global Survey on Risk Management and Internal Control](#), could be:

- *Internal control is an integrated part of an organization's governance and risk management system, which is effected, understood, and actively followed by the organization's governing body, management, and other personnel, to exploit opportunities and manage the risks in achieving the organization's objectives through, among other things:*
 - *effective and efficient strategic and operational processes;*



- *providing reliable information to internal and external users for timely and effective decision making;*
- *ensuring conformance with applicable laws and regulations, as well as with the organization's own policies, procedures, and guidelines;*
- *safeguarding the organization's resources against loss, fraud, misuse, and damage; and*
- *safeguarding the availability, confidentiality, and integrity of the organization's information systems, including IT.*

Include strategic objective

The PAIB Committee notes that although the strategic objective is included in the COSO ERM Framework and ERM Cube, it is still missing in the revised IC Framework and IC Cube. The Committee recommends including the strategic objective—as an additional example of an objective—both in the IC Framework and in the IC Cube, not only to further broaden the scope of the IC Framework but also to better align the IC Framework with the ERM Framework. This suggestion does not affect the overall recommendation, as mentioned above, that the internal control objectives in the IC Framework should be expanded (to “achievement of the organization’s objectives”) to cover all relevant opportunities and risks to an organization in achieving its objectives.

Include objective setting component

Even though the *achievement of objectives* is at the heart of the COSO definition of internal control, objective setting unfortunately is not included in the components of internal control. The PAIB Committee believes that such a crucial aspect of internal control warrants inclusion in the revised IC Framework as a component. This will not only assure better alignment with the related COSO ERM Framework (which *does* include “objective setting” as a separate component), but also emphasize that strengthening an entity’s systems of internal control can only be done from the perspective of the organization’s objectives. In this light, it is useful to recollect that “objective setting” was a separate component in the exposure draft of the original 1992 IC Framework, but has been excluded from the final version for unclear reasons.

Balance the various benefits of internal control

Possibly as a result of its importance for SOX attestation, the IC Framework overemphasizes the benefits of internal control over external financial reporting to meet regulatory requirements, for example in paragraph 103. Although the PAIB Committee fully agrees with this specific benefit, it also believes that the imposition of additional rules and requirements that have resulted from high-profile organizational failures, as well as the resultant time-consuming and costly compliance efforts, have obscured the fact that a wider range of internal controls—i.e., also focused on other important risks to an organization besides external financial reporting risks—can actually save time and money, and promote the creation and preservation of value. Therefore, the Committee recommends a better balance of the various benefits of internal control.

In addition, the IC Framework repeatedly singles out *financial* performance—e.g., paragraph 9: “Implementing a system of internal control allows management to stay focused on the organization’s pursuit of its operations and financial performance goals...” This unnecessarily limits the scope of the



framework and the Committee recommends substituting “financial performance” with “organizational performance” throughout the text.

The Committee also noted that the IC Framework singles out “reliable reporting” as one of the objectives of internal control, both in the definition and throughout the framework.¹ It believes, however, that a focus on only the reliability objective, although important, is too narrow. Reporting objectives, external or internal, are primarily driven by user needs and not by regulation.² The Committee recommends better alignment with the various quality criteria in multiple conceptual frameworks on financial reporting.

Revise definition of risk

The PAIB Committee also noted that the definition of risk in the IC Framework³ is unnecessarily biased toward adverse events and/or negative consequences. This obscures the fact that risk and risk taking can also be beneficial to the achievement of objectives. Therefore, the Committee recommends better alignment with the definition of risk in the International Organization for Standardization’s ISO 31000 Risk Management Standard, in which risk is “the effect of uncertainty on objectives,” regardless of positive and/or negative effect.

In the nature of business, risks are taken every day in order to deliver appropriate and competitive levels of return. Risk management is about understanding the nature of these risks, assessing the impact they would have if they materialized, and defining internal control actions to minimize the negative impact and optimize the positive impact were they to materialize. In doing so, the business benefits from the effective management of opportunities and threats across the organization.

Revise document structure

The text of the IC Framework is too long and not particularly readable. This inhibits understandability and ease of use for people working at the management level within organizations, such as many professional accountants in business. The Committee is aware of the existence of the much more accessible executive summary. To foster wider acceptance and better understanding of the framework, the Committee recommends redrafting the current executive summary into a new framework, possibly supplemented with the summaries of the attributes from the chapter ends of the current framework, and reworking the current IC Framework into additional “application guidance.”

Increase general applicability

Many concepts and principles of the updated IC Framework are universally applicable. However, organizations in various geographies might find the framework less applicable or might prefer other frameworks. For example, principle two states that: “The board of directors demonstrates independence

¹ An exception is paragraph 205, which elaborates on the various reporting objectives. However, it does not explicitly acknowledge that all other objectives also need to be brought under the span of internal control.

² See the [IFAC interview](#) with Sam DiPiazza, the recently retired PwC Chief Executive Officer, in which he explains: “It is critical that financial reports continue to evolve and become more understandable and relevant to the various users. Otherwise, it is very difficult for boards to provide good governance and to provide good information for investors to make any rational economic decisions around allocation of capital.”

³ IC Framework: “Risk is the possibility that an event will occur and adversely affect the achievement of objectives.”



of management and exercises oversight for the development and performance of internal control.” In some jurisdictions where there is one board (typical in Anglo-Saxon countries), the principle is understandable. However, when used outside that context, for example in a two-tier management structure, the principle does not apply. Many organizations across the globe, large and small, use a two-tier governance model (for example, the Rhineland model) where a separate “supervisory” board of independent non-executives performs an oversight role over the management board. In these situations, actions reserved for management cannot be transferred to the supervisory board, or vice versa.

In addition, the Committee believes that the IC Framework is not particularly conducive to small organizations when it “requires” independent directors and the use of an internal audit function. These are often simply not available to a smaller organization. The IC Framework needs to recognize this and discuss what can be done to compensate in a small organization environment. More generally, the Committee recommends that the IC Framework should be flexible to accommodate various organizational types and contexts.

Modify the principles

The 17 newly formulated principles certainly are helpful for getting a proper understanding of an organization’s system of internal control. Contrary to the limited scope of the definition, the objectives, and the components, all of the principles and most of the underlying attributes set out in the updated IC Framework are formulated much more broadly and, therefore, have a more general applicability. This is another argument to free the IC Framework from its unnecessary restrictions, not only in the definition, the objectives, and the components, but also in many of the underlying explanatory paragraphs.

Additionally, the set of principles can work in practice as a normative framework, for instance for professional accountants in business responsible for the preparation of the internal control statement. In this respect, the PAIB Committee believes that organizations can have effective internal control even if one or more of the 17 principles are not present and functioning—if the organization can demonstrate in other ways that it sufficiently manages the relevant risks to the organization in all their aspects.

The PAIB Committee recommends the following changes to the principles:

- Principle 5 could be interpreted to mean that top level executives delegate responsibility for internal control to individuals/departments on lower levels and do not assume sufficient responsibility themselves. However, the tone and action at the top are critical in this respect. The principle and underlying attributes should therefore clearly convey that management has to lead by example with respect to internal control and should continuously convey the importance of maintaining an appropriate degree of internal control and the importance of everyone’s responsibility in achieving it.
- The potential for fraud (principle 8) is an important risk. However, it is unclear why the IC Framework singles out only this specific type of risk. It should be considered whether to have a paragraph discussing the various sources of risk, one of them being fraud risk.
- Principle 12 is difficult to read and understand, certainly when compared with principle 10. Rewording the principle would make it more understandable, for example: “The organization deploys control



activities through policies that establish what is expected, as well as through relevant procedures that put the policies into action.”

- In the same sense, it is unclear why control activities over technology are singled out in principle 11. For most organizations, information technology is now so intertwined with their regular processes that the specific technology aspects should be fully integrated in the mainstream process control and no longer be singled out. Moreover, it is unclear why this principle is formulated around the controls over technology instead of the underlying risks with technology (as principle 8 does when discussing fraud risks). The fact remains that organizations need a full understanding of the risks and controls around their often extensive use of technology. It should be considered whether this notion could be included in the guidance to principle 10, rather than in a separate principle. Alternatively, the framework could better explain the differences between what is covered by principle 10 and principle 11.
- Related to principles 16 and 17, paragraph 89 of the IC Framework, sixth bullet: the use of inaccurate data to prepare management information should be reclassified from a potential minor to a potential major non-conformity, as this can lead to incorrect decision making by management and large risk.

Refer to additional application guidance

Despite the existence of sound internal control frameworks it is often the application of such frameworks that fails or could be further improved in many organizations. Therefore, the PAIB Committee has recently [proposed additional international guidance](#) on *Evaluating and Improving Internal Control in Organizations*. With this publication, the Committee aims to provide a practical guide—complementary to already existing internal control frameworks and based on those internal control issues that are often applied incorrectly—that focuses on the role of professional accountants in business and how they can support their organizations in evaluating and improving internal control as an integrated part of organizations’ governance, risk management, and internal control systems. Publication of the final IFAC guidance is planned for later in 2012 and will be available free of charge from www.ifac.org/paib. The IC Framework could refer to such additional application guidance in one of the appendices or online.

For the convenience of the development team, we have included our comments on the specific questions outlined in the [COSO Feedback Document](#) in appendix A, as well as a few editorial suggestions in appendix B to this response. We hope you find them useful while finalizing the IC Framework. Please do not hesitate to contact me should you wish to discuss any of the matters raised in this submission. We also welcome further discussions on how IFAC’s PAIB Committee can continue supporting the work of COSO.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Roger Tabor", with a stylized flourish at the end.

Roger Tabor
Chairman, IFAC Professional Accountants in Business Committee



Appendix A: Comments on the specific questions outlined in the [COSO Feedback Document](#)

Question 1. Are you a member of one or more of the COSO organizations?

No. [IFAC](#) is the global organization for the accountancy profession dedicated to serving the public interest by strengthening the profession and contributing to the development of strong international economies.

Question 2. Are you responding on behalf of yourself or an organization or company?

The comments are submitted on behalf of IFAC's Professional Accountants in Business Committee.

Question 3. Where do you reside?

IFAC has offices in New York, NY, US and in Toronto, Canada.

Question 4. Where within your organization do you apply the COSO Framework?

Not applicable.

Question 5. The updated Framework will help strengthen an entity's systems of internal control.

Somewhat disagree. The PAIB Committee doubts that an entity can achieve effective internal control by limiting the span of its internal control system to the scope of this IC Framework.

Question 6. The updated Framework is internally consistent and logical.

Somewhat disagree. Even though the *achievement of objectives* is at the heart of the COSO definition of internal control, it unfortunately is not included in the components of internal control.

Question 7. The updated Framework is written in a manner that is understandable and provides ease of use.

Somewhat disagree. According to the PAIB Committee, the text of the IC Framework is too long and not particularly readable.

Question 8. The updated Framework is applicable to organizations of varying legal structures and sizes, and operating in various geographies and industries.

Somewhat agree. Many concepts of the updated IC Framework are universally applicable. However, organizations in other geographies might find the framework less applicable or prefer other frameworks.

Question 9. The updated Framework will impose additional burdens on entities' reporting on internal control—e.g., reporting on internal control over external financial reporting based on Sarbanes–Oxley Act of 2002 (SOX) requirements.

Somewhat disagree. The revision did not lead to fundamental changes in the IC Framework, although it could be argued, based on the internal control failures over the 20 years since the original framework came into existence, that such changes would be necessary to fully achieve the objective of this project.

Question 9.a. If you believe that there is an additional burden, is the change appropriate?

The PAIB Committee believes that a more substantively revised IC Framework would and should lead to additional internal control actions in many organizations, especially those that only marginally complied with the extant IC Framework.



Question 10. Compared to the 1992 framework, the updated Framework creates a higher threshold for attaining effectiveness of internal control.

Somewhat disagree. See responses to question 9.

Question 11. The 17 principles set out in the updated Framework are a complete set of principles.

Somewhat agree. Contrary to the limited scope of the definition, the objectives, and the components, the principles and most of the underlying attributes set out in the updated IC Framework are formulated much more broadly and, therefore, have a more general applicability.

Question 12. The 17 principles with related attributes are helpful in describing important considerations of an effective system of internal control.

Somewhat agree. However, changes to the IC Framework remain necessary for effective overall internal control, in particular because its scope is too narrow.

Question 13. There are necessary changes to the principles.

Somewhat agree. The PAIB Committee considers the concept of principles as helpful but has provided a number of recommendations in the main body of this response.

Question 14. An entity can conclude that it has effective internal control if one or more of the 17 principles are not present and functioning.

Somewhat agree. The PAIB Committee believes that organizations can have effective internal control if the organization can demonstrate in other ways that it sufficiently manages its relevant risks.

Question 15. The updated Framework appropriately expands the reporting objective category (i.e. internal and external reporting, financial and non-financial reporting).

Somewhat agree. The IC Framework should have expanded its internal control objectives even further to cover all relevant opportunities and risks to an organization in achieving its objectives.

Question 16. The expanded reporting objective, and the manner in which this objective category is presented in the Framework, does not diminish our ability to apply the Framework when reporting on internal control over external financial reporting (ICoFR).

Strongly agree. The PAIB Committee believes that the expansion of the reporting objective is increasing, instead of diminishing, an organization's ability to apply the IC Framework when reporting on ICoFR.

Question 17. The updated Framework provides an appropriate balance of reporting, operations, and compliance related approaches and examples.

Somewhat disagree. The PAIB Committee believes that limiting the scope of the IC Framework to reporting, operations, and compliance is arbitrary and unhelpful to achieve effective internal control.

Question 18. Are there any other general comments that you would like to provide?

See also the recommendations in the main body of this comment letter.



Appendix B: Textual/Editorial Suggestions

The PAIB Committee also provides the following textual/editorial suggestions.

1. The boilerplate at the front of the document could be reduced or moved to the back, as the foreword now starts at page 11.
2. The COSO definition rightly says that “internal control is effected by people.” In this respect it is odd that the important chapter about roles and responsibilities is placed at the back of the document. The Committee recommends putting the roles and responsibilities chapter toward the beginning of the guidance, for example as part of the framework section. A subsidiary argument for moving the roles and responsibilities chapter is that it does not logically fit in the “components of internal control” section. This is also true for the chapter on limitations of internal control. It should be considered whether that should be moved as well.
3. The document would become more readable by using the “-ing” form instead of the “-es” form in the titles. Additionally, the overlap between titles and principles could be reduced by deleting the verbs or by deleting the title as a whole, as they are similar and, therefore, redundant. For example, on page 27 of the IC Framework:
 - Title: *Demonstrates Commitment to Integrity and Ethical Values*
 - Principle 1: *The organization demonstrates a commitment to integrity and ethical values.*
4. In paragraph 7, as well as in the executive summary, reference is made to the concurrent release of guidance on external financial reporting, but no mention is made of the 2009 COSO Guidance on Monitoring Internal Control Systems, which organizations can continue to use.
5. Paragraph 72: having an effective system of internal control does not automatically mean that “management and the board of directors have reasonable assurance that the organization understands the extent to which operations are *managed effectively* and *efficiently*.” Effective internal control does not automatically imply efficient operations, nor does it apply that the operations are *managed* effectively and efficiently. Instead, it means that those in the organization “have reasonable assurance that all the components of internal control around its operations are present and functioning” (principle 16).
6. In paragraph 78 an example could be included to increase understanding. See also the Committee’s proposal to elaborate the use of judgment into a proper principle.
7. The final sentence of paragraph 79 (“However, in the absence of an attribute being present and functioning, a deficiency may still exist.”) creates confusion and should be deleted.
8. In paragraph 88, tenth bullet, it would be more appropriate to use the word “providing” instead of “acquiring” as most companies provide the data to actuaries for the purpose of valuation.
9. In paragraph 91, it should be considered whether to replace “attaining access to *low-cost* human resources” with “*additional* human resources.”
10. Paragraph 110 and throughout the document: more specific differentiation between documentation and registration would improve clarity of the IC Framework. An internal control system is usually *documented* in policies and procedures (documentation). However, evidence of the performance of activities that are part of the system of internal control is usually *recorded* in registrations (*not* documentation).
11. Paragraph 201 shouldn’t start with the words “as well.”



12. The first sentence of paragraph 252 (“Management may also need to review the level of risk in light of changes and makes it no longer desirable to accept that risk ...”) does not read correctly and should be revised.
13. Table on page 71, row 6c (“Reflects management’s choices”) should be marked as relevant in the external reporting columns. Additionally, external reporting management typically needs to make many choices among available alternative treatments or methods of presentation, even more so in the more principles based jurisdictions.
14. In paragraph 286, first bullet, replace the words “support that” with “ensures.”
15. In paragraph 290, the second sentence is unclear and should be redrafted for improved understanding.
16. Paragraph 334 appears to be an “orphan” paragraph number. The text is part of paragraph 333.
17. In paragraph 391, the second bullet should be “internal audit function” instead of “internal audit group.”
18. Second to last attribute of principle 16 on page 116 (“Objectively Evaluates—Separate evaluations are performed periodically to provide objective feedback.”) should be modified as it is not in line with the notion that separate evaluations are not mandatory, nor with the notion that also ongoing evaluations can be done with a very high degree of objectivity (for example, regular reviews by risk management departments of lending decisions in a financial institution).