

November 20, 2012

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

**Re: Internal Control over External Financial Reporting: Compendium of Approaches and Examples and Illustrative Tools for Assessing Effectiveness of a System of Internal Control**

Dear Mr. Landsittel,

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 Drafts, *Internal Control over External Financial Reporting (ICEFR): Compendium of Approaches and Examples (Compendium)* and *Illustrative Tools for Assessing Effectiveness of a System of Internal Control (Illustrative Tools)*.

The committee also notes publication of the revised version of the previously exposed updated COSO *Internal Control—Integrated Framework* (the IC Framework). Whilst we appreciate all the effort that has gone into the revision, including a number of improvements, we believe that, overall, the revised version does not reflect the more fundamental changes proposed in the PAIB Committee's [response](#) to the first exposure draft of the updated IC Framework, as well as those recommended by many of the [other respondents](#). When developing the final version, we respectfully request COSO reevaluate our earlier feedback, as many of our concerns regarding the updated IC Framework are not addressed in this revised version and most recommendations are still applicable.

In particular we would stress the following:

1. For the IC Framework to remain relevant in an environment where we already perceive an evolving trend towards greater integration, the PAIB Committee strongly recommends that COSO further integrate its IC Framework with its Enterprise Risk Management (ERM) Framework, as well as converge with other frameworks, standards, and guidelines on governance, risk management, and internal control from across the globe. This will better enable organizations to make internal control a natural and integrated part of their overall risk management and governance arrangements.
2. The revised IC Framework should embrace a wider perspective than its current limited application to internal control over reporting, operations, and compliance, for example, by broadening the definition of internal control so as to permit the inclusion of other areas, such as business strategy and finance, in which internal control also plays a crucial role. 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.



3. The text of the IC Framework, as well as the companion documents, remains too long and discursive. To address this, the committee suggests it would be feasible to redraft the current executive summary so it becomes the new framework, while re-presenting the full IC Framework as additional “application guidance.” In our view this would be a positive move that would foster wider acceptance and better understanding of the framework, generally making it more accessible and user-friendly, especially for those charged with governance and others in senior positions within organizations, regulators, oversight bodies, etc.

The PAIB Committee firmly believes that it is in COSO’s long-term interest to adopt these and the other recommendations to the previous exposure draft in order to make its IC Framework more relevant to the broader global community and the challenges faced. We believe that to not do so would be a significant lost opportunity.

#### **General Comments on the Compendium**

The PAIB Committee welcomed COSO’s decision to publish additional guidance focused solely on internal control over external financial reporting. The committee recognizes the importance of preserving a relatively stable IC Framework for entities’ reporting on internal control over external financial reporting—for example, based on the requirements of the US Sarbanes-Oxley Act of 2002—and such additional guidance may provide for that need. At the same time, this should release COSO from its obligations to this particular stakeholder group and clear the way for renewed thought leadership in the revision of the underlying IC Framework, taking on board more fundamental, but necessary, changes, including those we suggest. Unfortunately, this opportunity has not yet materialized in this revised version of the IC Framework and its companion documents, which remain overly focused on risks associated with financial reporting. All the lessons we have learnt over the last ten years suggest these are less relevant to the risk landscape than in the past.

With respect to the Compendium, the PAIB Committee believes it is an appropriate response to the call for increased practical guidance to supplement the conceptual framework, as voiced in COSO’s kick-off survey for this revision project, and can be a valuable addition to the IC Framework. It forms a comprehensive “workbook” for those who have to design, implement, and conduct internal control over external financial reporting for their organization. A workbook with similar approaches and examples could also be useful for the full scope of internal control in organizations. The committee recommends COSO consider such additional publications, preferably in combination with its ERM Framework.

#### **General Comments on the Illustrative Tools**

The PAIB Committee also believes that the Illustrative Tools can be helpful for those who have to design, implement, and conduct internal control. However, much of the content in the templates is a repetition of text from the IC Framework. To substantially shorten this particular volume, as well as the total set of COSO internal control documents, which are almost 550 pages in total, we suggest making the Illustrative Tools much shorter and simpler to use by using modern technology. For example, in the text version, COSO only provides blank “example templates.” With the various online tools that already exist, organizations can automatically generate populated templates, based on the latest version of the underlying document, and make them more tailored to their organization.



We would also like COSO to consider additional technological alternatives, such as developing short video presentations on the various scenarios in this volume or offering webinars.

For the convenience of the development team, we have included our comments on the specific questions outlined in the [COSO Feedback Survey](#) in the addendum to this response. We hope you find our recommendations useful and constructive as you finalize the IC Framework, the Compendium, and the Illustrative Tools.

We would also like to draw your attention to the June 2012 publication by the PAIB Committee of our International Good Practice Guidance, [Evaluating and Improving Internal Control in Organizations](#), highlighting areas where the practical application of existing internal control standards and frameworks often fails in many organizations. The guidance is available free of charge on the [IFAC website](#) and we would be happy for the IC Framework to refer to such additional application guidance in its appendices and online. In addition, the committee has started a new project to develop guidance on integration of risk management and internal control in the governance of organizations. We would value COSO's input for that project.

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 the IFAC 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

#### **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. It is comprised of 172 members and associates in 129 countries and jurisdictions, representing approximately 2.5 million accountants in public practice, education, government service, industry, and commerce. 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.

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.



## Comments on the Specific Questions Outlined in the [COSO Feedback Survey](#)

### **Question 1. What is your COSO Affiliation?**

[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. IFAC participates in the Advisory Council to the COSO project to review and update the 1992 Internal Control-Integrated Framework.

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

The comments are submitted on behalf of the IFAC [Professional Accountants in Business Committee](#).

### **Question 3. What is your entity's legal structure?**

Founded in 1977, IFAC is a Swiss-registered association whose members are professional accountancy organizations.

### **Question 4. What is your entity's revenue?**

IFAC's annual report details the activities it has undertaken over the past year to fulfill this mission and extent to which it has met its strategic objectives. The latest annual report can be found at the IFAC website at [www.ifac.org](http://www.ifac.org).

### **Question 5. What is your role within the organization?**

Not applicable.

### **Question 6. Does your organization apply the 1992 COSO Framework to external financial reporting objectives?**

Although IFAC does not directly apply the 1992 COSO Framework to its own external financial reporting objectives, it refers to the framework in many of its publications (with respect to risk management and internal control), which can be found at the [Publications and Resources](#) section of the IFAC website.

### **Question 7. The ICEFR document will be useful in applying the Framework to your entity's external financial reporting objectives**

We agree. The PAIB Committee believes the Compendium is a valuable addition to the IC Framework for those who have to design, implement, and conduct ICEFR for their organization.

### **Question 8. The ICEFR document will impose additional burdens on entities' reporting on the effectiveness of internal control – e.g. reporting on internal control over financial reporting based on Sarbanes–Oxley Act of 2002 (SOX) requirements**

We somewhat disagree—the Compendium closely follows the revised framework, which did not fundamentally change through the revision. However, 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 objectives of this project. On the other hand, organizations that have not yet fully embraced all of the concepts of the original or revised framework are faced with more work now that those concepts are clear.



**Question 9. The ICEFR document is relevant for both larger and smaller entities**

We agree. The PAIB Committee believes that ICEFR is equally important for both larger and smaller entities, but that every size or type of organization—in fact every organization—needs to tailor its internal control system to its own unique risks and circumstances. As explained in paragraphs 33 and 34, most approaches and examples in the Compendium translate to both smaller and larger entities.

**Question 10. The ICEFR document is relevant for private, not-for-profit and government entities**

We agree—see our response to question 9. Paragraph 8 of the Compendium does identify the various types of entities, but does not explicitly state that this guidance is relevant to all types of entities. Perhaps this could be added in the revised version.

**Question 11. The ICEFR document’s approaches and examples clearly illustrate principles set out in the Framework**

We somewhat agree—the PAIB Committee found some examples in the Compendium to be somewhat simplistic and only a few of them are from organizations outside the US.

**Question 12. Additional approaches and/or examples are needed to illustrate the principles. If yes, please explain**

No additional approaches and/or examples are needed for this Compendium, but some additional variation in the examples could make them more internationally applicable (see question 11). However, as mentioned above, the committee recommends COSO consider additional compendia with approaches and examples for other control objectives in addition to external financial reporting.

**Question 13. Other comments on the ICEFR Discussion document**

There seems to be an underlying assumption in the Compendium that, because every risk is likely to have a financial reporting consequence, the only entry to risk management is via the financial statements. However, effective risk management and internal control in organizations are about delivering business outcomes within acceptable boundaries, and only partly about producing reliable financial statements. Organizations should, therefore, be forewarned that having effective ICEFR, although important, is only part of the overall control environment.

**Question 14. The expanded reporting objective set forth in the Framework does not diminish my ability to apply the Framework in an ICEFR context**

We 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 ICEFR. Moreover, the IC Framework should have expanded its internal control objectives even further, beyond ICEFR, to cover all relevant opportunities and risks to an organization in achieving its objectives.

**Question 15. The Framework appropriately discusses the role and relevance of components, principles, and points of focus**

We somewhat agree—see the PAIB Committee’s response to the first exposure draft of the updated IC Framework for additional information.



**Question 16. The Effective Internal Control chapter provides a clear understanding of the requirements for an effective system of internal control**

We somewhat agree; however, effective internal control should not be limited to only the objectives mentioned in the IC Framework, which might provide a false sense of security. Those charged with governance and others in senior positions within organizations—many of whom have not been specifically educated in the details of risk management—may not sufficiently understand that the IC Framework is referring to only a subset of risks. As a consequence, even when internal control is determined to be effective according to the IC Framework,<sup>1</sup> the organization might still be exposed to unacceptable risk. For example, financial risk might relate to uncertainty in interest, equity, or currency markets or to a mismatch on the balance sheet between the maturity of assets and liabilities. Exercising effective control over these financial risks involves more than controlling the related financial reporting consequences. Please also see the PAIB Committee’s response to the first exposure draft of the updated IC Framework.

**Question 17. The Framework appropriately requires that each of the five components be present and functioning for effective internal control**

We agree. Organizations generally need to have the five components of internal control present and functioning for effective internal control. See our response to question 16.

**Question 18. The Framework appropriately requires that relevant principles be present and functioning for effective internal control**

We somewhat agree. The PAIB Committee believes that *relevant* principles should be present and functioning for effective internal control. However, organizations can also have effective internal control if the organization can demonstrate otherwise that it sufficiently manages its relevant risks, in which case they should be able to explain why they deemed a principle irrelevant.

Contrary to the limited scope of the definition, objectives, and components, the principles and most of the underlying points of focus set out in the revised IC Framework are formulated much more broadly and, therefore, have a more general applicability. However, changes to the IC Framework remain necessary for effective *overall* internal control, in particular because its scope is too narrow.

**Question 19. The Framework appropriately balances discussions regarding reporting, operations, and compliance objectives**

We somewhat disagree. The PAIB Committee believes that limiting the scope of the IC Framework, and the discussions, to reporting, operations, and compliance is arbitrary and unhelpful for achieving effective internal control.

**Question 20. The Appendix E: Consideration of Public Comment Letters is clear and provides an understanding of the revisions made to the Framework, Exposure Draft (December 2011)**

The explanations of why principles 8 and 11 should not be folded in principles 7 and 10, respectively, are weak. They essentially state “we acknowledge the comment but disagree” without giving any reasoning.

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<sup>1</sup> See paragraph 88 of the IC Framework.



Enterprise risk management is handled in a similar fashion. Perhaps COSO could provide an explanation as to why it feels it is more appropriate to keep them separate and distinct.

**Question 21. The Appendix F: Summary of Changes to the Internal Control-Integrated Framework Issued in 1992 is clear and provides an understanding of the changes made**

The summary is clear and provides a concise but complete overview of the changes made. However, as mentioned previously, the PAIB Committee would like to invite COSO to make some additional, more-fundamental changes, as noted in its previous [response](#).

**Question 22. Other comments on the Framework**

In the view of the PAIB Committee, the text of the IC Framework is still too long and, mainly for that reason, not particularly easy to read or understand.<sup>2</sup> See the recommendations in the main body of this comment letter for more detail.

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<sup>2</sup> In fact, it is almost 30 pages longer than the previous revised version.