

What to Look Out for When Implementing
The COSO Framework Update



COMPLIANCE WEEK

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Bridging the Divide Between COSO Frameworks Old & New

By Tammy Whitehouse

A s companies work to implement the updated COSO internal controls framework, they are hearing a common refrain: "mind the gap."

That would be the gap between internal controls under the old framework and the added elements of the new one. Companies aren't just closing that gap, though; they are also using the opportunity to take a fresh look at their entire systems of internal control. Working through the implementation of the new framework, companies are spending a lot of time talking about risk assessments, tone at the top, outside service providers, and technology, according to internal control experts who are observing and assisting with the process.

"We're seeing a lot of companies having really robust discussion and dialogue around entity-level controls," says Brent Olson, a director at McGladrey who has helped a number of companies map their controls to the 2013 COSO Internal Control — Integrated Framework. "The enhanced guidance in the 2013 framework, particularly around entity level controls, has provided a lot of companies a point of reference to benchmark their existing controls."

COSO, or the Committee of Sponsoring Organizations, updated its 20-year-old framework—which nearly all U.S. public companies rely on to comply with internal control reporting requirements under the Sarbanes-Oxley Act—with the expectation that companies would transition to the new version by the end of 2014, when the old framework will be put out to pasture. The Securities and Exchange Commission hasn't explicitly said it will require companies to adopt the updated framework, but staff members have said they defer to COSO on its time line and would expect companies to clearly disclose which framework they're following.

The 2013 framework doesn't drastically change the principles that must be in place to assert effective internal control as required under Sarbanes-Oxley, but it does more explicitly require all 17 articulated principles to be present and functioning in concert, says Kevin Hyams, a partner in charge at audit firm Friedman. "COSO 2013 gives equal billing to all five components and 17 principles working together," he says.

That's perhaps more emphasis than companies and auditors historically have placed on some aspects of the framework, says Hyams, especially with respect to the control environment and control activities. "That's not to say people didn't have an effective control environment. Maybe they just didn't have the evidentiary documentation, or there might have been documentation but the strong oversight by the board might not have been emphasized previously."

Filling in the Cracks

Sandy Herrygers, a partner with Deloitte, says she sees gaps in some specific areas. "We have not seen many companies identifying principle gaps, which would be indicative of a material weakness in internal control," she says. Instead, companies are identifying missing controls, controls that are missing specific attributes, or controls that exist but aren't tested for design or operating effectiveness. Companies also are finding evidence gaps, or instances where controls exist but aren't adequately documented.

The gaps are most common, Herrygers says, in controls over risk assessments, including fraud risk and change management, controls over outsource service providers, and controls over information quality. With the fresh look at internal controls, companies also are shoring up areas where there's been some history of restatement, material weakness, or fraud, she says, such as controls around technical accounting skills, complex and non-routine transactions, and segregation of duties.

Mike Rose, a partner at Grant Thornton, says mapping and implementation in the past few months has led to greater focus on principles six through nine in the new framework, all supporting the risk assessment component of the framework. "Under the old framework, we had the risk assessment component, but we focused a lot on transactional level risks," he says. "Now it's expanded to cover risks at the entity level."

Especially with respect to fraud risk, emphasis in the past has focused on transaction-level risks, but the framework update has driven greater attention to entity-level fraud risks, says Rose. As a result, companies are talking a lot about incentives and pressures on people within the organization, as well as the risk of misappropriation of assets or other illegal acts, he says. "The fraud risk assessment is the biggest area we're seeing," he says. "It's almost across the board."

With respect to governance or tone-at-the-top, companies are looking closely at the extent to which board oversight is

EFFECTIVE INTERNAL CONTROLS

Below is an excerpt from the Committee of Sponsoring Organizations' Framework Transition Guidance.

Codified Principles. The 1992 Framework conceptually introduced 17 relevant principles associated with the five components of internal control. But these concepts were implicit in the narrative. Because they are essential in assessing that the five components are present and functioning, these concepts are now explicitly articulated in the 17 principles. The COSO board believes each principle adds value, is suitable to all entities, and therefore, is presumed relevant. If management determines that a given principle isn't relevant to the organization, it should document the rationalization.

Requirements of Effective Internal Controls. For management to conclude that its system of internal control is effective, all five components of internal control and all relevant principles must be present and functioning. Being "present" implies a given component or principle exists within the design and implementation of an entity's system of internal control. "Functioning" implies the component or principle continues to exist in the operation and conduct of the control system. Effective internal control also requires that all five components operate together in an integrated manner. Management can conclude they do if each component is present and functioning and the aggregation of internal control deficiencies across the components doesn't result in one or more major deficiencies.

Source: COSO.



emphasized and documented, says Tracy Thames, senior consultant at consulting firm RoseRyan. "We're seeing companies that may not have called it out as an internal control, but they were still performing the exercise," she says. As an ex-

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Brent Olson, Director, McGladrey

ample, boards may not have documented in meeting minutes that they have addressed certain issues within their oversight responsibility, she says, or they may need to reword control documentation to assure existing controls adequately cover points of focus highlighted in the framework.

Controls over outsource service providers also are getting a fresh look, says Olson. Many companies have relied on "service organization control" reports, or reports provided to them by outside service providers asserting their control status, as evidence of control. "Now they're taking a more in-depth look at the controls and the monitoring of third parties," he says.

Bill Watts, a partner at Crowe Horwath, says companies are taking a fresh look at the controls over information that goes out to third-party service providers and the information that comes back from them. "Those controls probably weren't as formalized as they could have been," he says.

Technology controls in general are getting a fresh look with the framework implementation, says Rose. "Where management has information coming into the financial reporting process that could be from other systems, we're seeing more rigor around those interfaces—how we test those reports for accuracy and completeness and how those reports are utilized," he says.

Christensen, executive vice president at consulting firm Protiviti, says the biggest dialogue he hears around the new framework now centers on whether companies can get it implemented in time to rely on it for 2014 year-end reporting. "Most companies have found the effort wasn't as onerous as they originally thought," he says. "But some are finding the mapping of controls to the framework is taking more time or effort than they have runway or resources to complete.

Hyams says larger accelerated filers subject to the Sarbanes-Oxley audit of internal controls had less of a leap to make from the old framework to the new one. "For non-accelerated filers with less resources, it's quite a burden," he says. "I'd be surprised if any accelerated filers don't assess themselves under the 2013 framework, but it's going to be a sliding scale from accelerated filers to smaller reporting companies, and understandably so."

Auditors May Disclose Framework Choice in Audit Report

By Tammy Whitehouse

ompanies choosing to stick with the old COSO internal control framework this year might find a mention of that fact by auditors in the audit report.

Deloitte & Touche recently issued an alert on its observations of the COSO 2013 Internal Control — Integrated Framework adoption saying where companies are not adopting the new framework this year, auditors should indicate in their audit reports exactly what framework was used. "We believe that in a manner consistent with the approach for disclosing the exact COSO framework used in management's ICFR assessment, it would be appropriate to indicate in the auditor's report the exact framework used," the alert says.

Deloitte says it has observed that most companies are moving forward adopting the 2013 framework this year in accordance with COSO's guidance on transitioning to the new version. COSO updated the framework and released it in 2013, telling companies the old framework to be considered "superseded" by Dec. 15, 2014. The SEC says companies are required to use a "suitable" framework, but they haven't explicitly said they would consider the 1992 framework unsuitable. The SEC has indicated it defers to COSO's transition guidance and expects companies to disclose what framework they are using to achieve compliance

with Sarbanes-Oxley reporting on internal control over financial reporting.

In its alert, Deloitte says most companies are adopting the new framework because boards, audit committees, and management want to use "the latest guidance and leading practices," and because they believe investors, bankers, regulators, and other stakeholders will expect it. They also do not want to be perceived as lagging their industry peers, the firm says. The alert provides less insight into why some companies might choose not to adopt the new framework this year. "Their decisions were generally based on consultations with a number of stakeholders, including the board, audit committee, and internal and external auditors," Deloitte says. "Regardless of their decision, companies should clearly disclose in their annual assessment of ICFR whether they used the 1992 framework or the 2013 framework."

Deloitte also provides a principle-by-principle summary of the implementation difficulties companies have encountered as they perform their gap analyses and update their control environments to reflect the new framework. Trouble spots include tendencies to slip into a check-the-box approach, managing change and its inherent risks, segregation of duties, over reliance on imprecise controls, controls around outsourced service providers, various IT control issues, and control design.

All Eyes on Internal Controls as Year-End Close Nears

By Tammy Whitehouse

A s companies begin preparing now for the year-end close, audit experts are warning them to take these final few months of the year to double check documentation. With the Public Company Accounting Oversight Board putting pressure on audit firms to scrutinize internal controls and other areas, that scrutiny is likely to trickle down to issuers.

Although no broadly applicable accounting standards took effect this year, auditors are under a fresh round of orders from their regulators to get tougher and demand more evidence in a number of areas, especially internal controls over financial reporting, revenue recognition, and accounting estimates. "It's been a fairly quiet year in terms of new accounting standards taking effect," says Pat Durbin, a partner with PwC. "The big focus this year is more on internal control."

The PCAOB has alerted auditors once again to pay closer attention to internal controls, especially whether companies have demonstrated that controls are operating effectively and at a level of precision that would mitigate any identified risk of misstatement. The PCAOB is asking auditors why they don't have more evidence to support that. "Auditing practice has continued to evolve and mature in terms of how we audit internal control," says Durbin. "It's about increasing our understanding of how a company's controls are implemented through their specific financial reporting risk and then designing our audit tests accordingly."

On top of the PCAOB's focus, most public companies are adopting a new framework for internal control after COSO indicated its Internal Control — Integrated Frame-

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Angela Storm, Partner, KPMG

work, updated last year, would take the place of its 1992 framework at the end of 2014. The bones of the updated version are familiar, but the 2013 framework explicitly requires companies to demonstrate that all 17 principles of internal control are present and functioning. "Registrants should carefully consider how their established policies and procedures, standards, processes, structures, and controls demonstrate that the principles are present and functioning in the organization's system of internal control," says Angela Storm, a partner with KPMG.

Sara Lord, a partner at McGladrey, says she sees com-

panies taking a bit longer than anticipated to work through the new framework. With the new framework and the PCAOB's alert to auditors, companies can expect auditors to search for evidence that shows controls are operating at a particular level of precision. "We're still seeing companies working through whether the documentation is where it needs to be to provide that level of understanding and that detail," she says. "The PCAOB is really focused on making sure the documentation and testing procedures are where they need to be."

Kevin Wydra, a partner at Crowe Horwath, says he just wrapped up work with the PCAOB on the firm's inspection, and inspectors are as focused as ever on precision. "Above and beyond the simple sign-off, how did the review occur and what was the depth of that review?" he says. "Within that, how does that person know the information being relied upon is complete and accurate? If you haven't buttoned

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THE SEC'S PLAN

Below, Keith Higgins, director of the SEC Division of Corporation Finance, discusses the SEC's plan to make disclosures more effective.

So what is the Division's plan for the disclosure project? As you know, the Commission released a staff report that presents an overview of Regulation S-K and the Commission's initiatives over the years to review and update the disclosure and registration requirements. The report was mandated by Congress under the JOBS Act and, although the mandate focused on emerging growth companies, the report is intended to facilitate the improvement of disclosure requirements applicable to companies at all stages of their development. In addition to serving as a comprehensive source for the regulatory history of Regulation S-K, the report identifies specific areas that the staff believes could benefit from further review.

The report was a springboard for further action, and I couldn't be more pleased that the Chair asked the Division to lead the effort to develop specific recommendations for updating the disclosure requirements. Our goal is to review specific sections of Regulation S-K and S-X to determine if the requirements can be updated to reduce the costs and burdens on companies while continuing to provide material information and eliminate duplicative disclosures. At the same time, while always mindful of the costs and burdens of our regulation, we will ask whether there is information that is not part of our current requirements but that ought to be. While looking for ways that we can streamline our disclosure requirements is an important element of our review, reducing the volume of disclosures is not the sole end game. You may be surprised to learn that there are many investors who have expressed an appetite for more information, not less. If we identify potential gaps in disclosure or opportunities to increase the transparency of information, we may very well recommend new disclosure requirements.

Source: SEC.



Buying Time on COSO's Internal Control Framework

By Tammy Whitehouse

with no explicit regulatory mandate to adopt the recently revised internal control framework by the end of 2014, companies sweating the sunset of the old framework are starting to ask: "Can we take another year to work on this?"

Ever so cautiously, auditors are starting to say: "Sure. Just disclose it."

"People are starting to make that appeal: 'Is this the year?'" says Brian Christensen, executive vice president at advisory firm Protiviti and leader of its internal audit and financial controls services. "We are starting to see that dialogue increase."

The 1992 Internal Control — Integrated Framework that virtually every public company in the United States relies on to achieve compliance with the Sarbanes-Oxley Act officially ceases to exist on Dec. 5, 2014. It will be superseded by the 2013 version of the framework updated by the Committee of Sponsoring Organizations, or COSO. The new framework reflects modern business conventions better than its 20-year-old predecessor and more explicitly requires the 17 principles of internal control to be present and functioning before an entity can assert it has adequate control over financial reporting.

COSO set the timeline for the old framework to expire and the new one to take effect, but has no regulatory authority to enforce it. The Securities and Exchange Commission has said it will defer to COSO's guidance on the sunset of the old framework at the end of 2014, but would expect companies that don't adopt the new framework to clearly disclose that fact and explain why.

Now, it seems, companies that are behind in the implementation of the new framework are starting to consider the delay-and-disclose option. "The transition date for U.S.-listed companies is a bit squishy," says COSO Chairman Robert Hirth. "COSO is not a standard setter or a regulator, so COSO can't make anyone do anything. So there's kind of this twilight zone of: when do you do it?"

KPMG is suggesting that companies should take the time they need to implement it properly. During a recent Webcast, KPMG partner Sharon Todd said she's noticing companies that waited until after filing their 10-K to begin the COSO framework implementation are finding the task a bit more daunting than expected. "Those that just started after the 10-K was filed are probably in for a bit of a rude awakening, and are now perhaps reconsidering, if they're a significant entity or multinational around the world, that perhaps next year might be a better transition date," she said.

KPMG Partner Dennis Whalen said during the same Webcast that the key for companies is to assure their implementation is thorough and robust. "Companies shouldn't rush to transition if they're not prepared for and don't have the resources to do it," he said. "But you can't be the last man standing in terms of being the only company that hasn't transitioned." In an alert to audit committees summarizing the issue, KPMG related that 35 percent of the 1,600 participants in the Webcast said they still weren't sure whether they would

complete the COSO implementation in 2014. Nearly 40 percent of participants said their companies had undertaken no significant transition activities at that point in time.

Deloitte said companies that started the implementation last year when the new framework was released are on track. "Others who started late have some catch-up work to do," says Sandy Herrygers, a partner with the firm. "Plenty of time remains to complete the implementation, but the project should be prioritized and staffed to achieve this timing." EY and PwC did not respond to requests for comment.

Delay Implementation?

Bill Watts, a partner at Crowe Horwath, says he's also hearing some discussion around whether companies can or should consider delaying implementation. He's been present at audit committee meetings where he's heard other audit firms counseling committees that they could defer or delay implementation if they see a reason to do so. "Our po-

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TRANSITION TIPS

Below KPMG offers tips based on the company's recent Webcast and survey on how best to transition to COSO 2013:

The transition to COSO 2013 may require more time and resources than expected. "Depending on how robust their existing internal control systems are, some companies are going to be surprised by the resources and effort this transition will require." Some 17% of Webcast listeners said they expect the COSO transition to be a "significant" undertaking in terms of time and resources. Others expect the effort to be moderate (47%) or minor (12%), but for a full 24%, time and resource requirements are still unclear. Companies may also be pleasantly surprised by internal controls they already have in place.

Understand and monitor management's transition process and timeline. Based on when the company plans to adopt the 2013 COSO Framework, "work backwards from there": Does management have sufficient time and resources in place to carry out the key transition steps—gap analysis, mapping of controls to principles, testing and remediation, and documentation? Is internal audit involved as needed?

Our Webcast survey found companies at various stages of their transition: 20% have completed a "preliminary gap assessment and transition plan," 20% have "mapped their controls to COSO's 17 principles," 11% have identified and remediated control gaps, 11% have evaluated their system of internal controls under COSO 2013, and 38% said "no significant transition activities have been undertaken."

Don't rush the transition process. "If the company isn't well into the process already and doesn't have the resources in place to make the transition in 2014, don't rush it."

Source: KPMG.

Too Many Moving Parts

Getting your internal controls in shape with the PCAOB and the SEC watching

Written by Joseph Howell

Introduction

The Public Company Accounting Oversight Board and the Securities and Exchange Commission appear to be focusing on internal controls with gusto not seen since the passage of the Sarbanes-Oxley Act of 2002.

In a <u>recent public statement</u>, PCAOB board member Jay Hanson said, "[In approximately 15 percent of audit reports] inspected in 2010, the PCAOB found that the firm had not obtained sufficient audit evidence to support its audit opinion on the effectiveness of internal control due to one or more deficiencies identified by the PCAOB ... Since 2010, these types of findings have continued."

They sure have.

In KPMG Draws Ire in 2013 Report; New Carping Over Old Quality Issues, Tammy Whitehouse reports, "The Public Company Accounting Oversight Board says KPMG failed in 46 percent of its inspected audits in 2013 to arrive at an adequately supported audit opinion, and failed to adequately address quality control issues raised in earlier inspections ... Among the Big 4, KPMG's 46-percent audit deficiency rate follows only EY, which drew criticism on 49 percent of its inspected audits in its 2013 inspection. The PCAOB flagged 32 percent of the audits it examined in 2013 at PwC, and 28 percent at Deloitte."

A substantial majority of the deficient engagements cited by the PCAOB were due to a deficiency in internal control over financial reporting (ICFR). In another recent article, Whitehouse reports, "Of the 28 E&Y engagements in which the board identified audit deficiencies, one related only to the audit of the financial statements—stated differently, all but one of the deficient engagements included an ICFR deficiency. Six of the 28 related solely to the ICFR audit."

Auditors have taken these criticisms seriously and have responded by changing both their audit approach and scope of work. On several occasions, auditors have performed additional extensive, costly, and time-consuming procedures subsequent to issuance of the auditor's opinion due to questions from the PCAOB on ICFR. These additional procedures sometimes lead to revisions to the management report and auditor's opinion.

Members of the SEC Professionals Group, an association of 6,200 professionals from over 2,800 public companies who actively prepare and file financial reports with the SEC, report that their auditors have recently expanded their audit scope of ICFR and are asking more aggressive questions about the basis for

management decisions. According to members, auditors are also requiring near absolute assurance that controls are consistent with prior years and across different locations, in addition to more proof of control performance.

On top of the SEC's warning that they are paying attention to which COSO Framework companies are using, the SEC has made it clear that updating to the 2013 COSO Framework is an opportunity for companies to revisit and improve their internal controls and processes. The SEC is adding to this pressure by sending comment letters questioning internal controls and increasing the number of enforcement actions taken due to deficiencies in internal controls.

For example, the SEC recently announced charges against the CEO and former CFO of a tech services company in Florida over internal controls violations. The law firm Morgan Lewis says the enforcement action is important, "because it doesn't involve any allegations of mis-statements in financial statements, deliberate or otherwise, nor does it contain any allegations of other wrongdoing, such a bribery or corruption."

Until this case, there had not been any standalone internal controls or certifications cases since SOX was enacted. Some SEC watchers believe this case foreshadows even greater scrutiny of internal controls by the SEC's Division of Enforcement.

The underlying problem

In the public versions of the PCAOB's inspection reports, the PCAOB stated flatly that audit firms have failed to obtain sufficient, appropriate audit evidence to support their opinions on the effectiveness of ICFR.

There are two possible causes for a lack of quality evidence. First, the client could actually have sufficient evidence, but the auditors failed to collect, organize, evaluate, and present that evidence in their work papers. Second, the client could actually lack sufficient appropriate evidence, and the auditors failed to identify that lack of evidence as a potential control weakness.

In interviews with internal control and SOX teams at companies experiencing these problems, Workiva has found a common theme. Many believe they have, or could get, the necessary evidence, but it is too disorganized and scattered to use effectively. They complain that they suffer from inconsistent versions of key documents and templates, inconsistent storage and retrieval practices, and cumbersome, time-consuming, and error-prone manual processes to capture and report evidence of performance.



There is no doubt about it—companies have way too many moving parts in the process. That includes too many:

- » Disconnected files to track easily
- » Versions of those files
- » Places where those files are stored
- » Different ways to distribute the files
- » Inconsistencies in key facts in those files
- » Manual steps to manage

The result is obvious—even when companies have well-designed controls that are operating effectively, they often don't have the evidence to give their auditors in a readily accessible and usable form.

The good news

Just as the integrated circuit allowed engineers to create small, inexpensive, and powerful electronic devices by reducing the number of discrete components, new cloud-based software technologies enable companies to reduce the number of moving parts in their process quickly, easily, efficiently, and inexpensively.

Cloud-based technologies ensure that companies have a single source of truth, wherever that truth is disclosed. Teams can stop hunting for the most up-to-date information to present to management, external auditors, and the audit committee—it's all in one place.

Among other things, these new technologies allow teams to:

» Collaborate in a controlled environment

Work concurrently on the same document without running into each other or interfering with each other's work, saving time and eliminating version control problems.

» Be confident all documents are accurate

Link data and information from one, single source of truth to an infinite number of documents, tables, charts, and presentations. Ensure control descriptions are accurately updated in the risk control matrix, process narratives, flow charts, testing documents, audit reports, and dashboards. Synchronize key data elements from primary sources, and track all changes made.

» Take control of change

Restrict changes to documents to only those entitled to make changes during a specified time via sophisticated, easy-to-use permissions. Track all changes made with complete history, and ensure consistent templates, instructions, and descriptions of key data elements across the organization and over time.

» Streamline collection of information

Eliminate e-mail as the primary source of distributing documents. This will reduce clutter and risk of distribution to unauthorized persons and speed up the collection, reporting, and aggregation of key data elements from multiple subsidiaries and business units.

» Simplify certification and reporting

Accelerate the process of requesting, collecting, and analyzing certifications and sub-certifications from performers of controls and others. Organize, store, and present evidence of control in digital binders that can be distributed, archived, and easily located.

By integrating the documentation, testing, and even performance of controls into a single source of truth, reporting teams reduce the number of moving parts, save time, gain control, and improve the quality of the information presented to auditors and managers.

Final words

Encouraged by the PCAOB and the SEC, auditors are turning up the pressure on their clients to improve their processes in light of the recent update to the COSO Framework and provide high-quality evidence of internal control over financial reporting.

What is your company going to do about it?

Companies that adopt effective solutions that reduce complexity, enable seamless editing and updating of information, and allow everyone to be on the same page will have a distinct competitive advantage over their peers.

About Workiva

Workiva, formerly WebFilings, is a leading provider of complex business reporting solutions and is used by more than 60 percent of the Fortune 500. The company's Wdesk cloud-based product platform brings ease and control to compliance, management, risk, and sustainability reporting. Wdesk combines documents, spreadsheets, and presentations that link your critical business data in one place. Information stays up to date and secure. You have complete control. And you don't even need IT to get started. It's simply the easiest and fastest way to get complex business reports done. See what we can do for you at workiva.com.

About the Author

Joseph Howell is Co-Founder and Managing Director of Workiva. Prior to founding Workiva, Joe served as Chief Financial Officer for a number of public and private companies. Joe is also Co-Founder, Organizer, and Community Moderator for the SEC Professionals Group. A Certified Public Accountant (inactive), he earned a bachelor's from the University of Michigan and a master's degree in accounting from Eastern Michigan University.



Dispatches From the Front on COSO Implementation

Companies find problem spots and frustrations and have many questions as they work to update the new framework for internal control

By Matt Kelly

ell, we are starting to get word from the field about companies' progress implementing the new COSO framework for internal control. Apparently we have a few weaknesses to discuss.

In theory, compliance and internal audit teams have been working hard all summer to implement the new framework, scheduled to go into effect on Dec. 15. And from what I've heard—both in personal discussions with various compliance officers and in articles written in Compliance Week and elsewhere—compliance departments are indeed trying to get the project done. But many still seem to be struggling with preliminary steps, such as explaining to their boards how the new COSO framework will be useful to them, or determining how to apply the new framework's 17 principles beyond the basic realm of financial reporting.

Let's start with the anecdotal evidence. I recently chatted with the compliance director at one large energy company who said his biggest challenge is articulating why his company should bother with the new COSO framework at all. He was frustrated with the framework's executive summary, intended to be the document that boards, CEOs, and CFOs should read to understand the value of the COSO 2.0 framework. Its main points are mostly common sense that executives assume the company is already following, he said, and translating that common sense into specific action plans is hard. Doing so for your audit committee, which already has too many responsibilities and too little time, is even harder.

As I read the executive summary, this compliance director has a point. Here's one excerpt:

An effective system of internal control demands more than rigorous adherence to policies and procedures: it requires the use of judgment. Management and boards of directors use judgment to determine how much control is enough. Management and other personnel use judgment every day to select, develop, and deploy controls across the entity...

The Framework assists management, boards of directors, external stakeholders, and others interacting with the entity in their respective duties regarding internal control without being overly prescriptive.

What COSO is trying to say here—that senior managers across the enterprise should be involved in establishing effective internal control—is important. Without question, companies today face much more intrusive compliance ob-

ligations that affect many more parts of the enterprise; compliance and audit executives need those other senior managers' help.

Still, one can easily see board directors, CEOs, IT directors, and others all reading that passage and snappishly thinking, "Yes, yes—but what am I supposed to do?" How much time should the company devote to internal control over financial reporting, versus general controls for IT? How will stronger internal control improve operations? How do we close whatever new control gaps we find? And as always, how much will implementation cost?

Questions like those are what linger on senior managers' minds. For the last 10 years compliance officers have been answering them through the specific lens of SOX Section 404 compliance. Now comes along the new COSO framework, seeking to go far beyond internal control over financial reporting. Suddenly those standard questions from the board and CEO are much harder to answer with much precision. We've seen some companies make outstanding efforts to take the COSO framework beyond financial reporting. (Boeing is one of them.) We need many more.

Meanwhile, the masses who are implementing the new COSO framework simply to stay on the good sides of their audit firms and the Securities and Exchange Commission—they're having a bumpy ride. We've already seen some audit firms start to give guidance on how a company might document a decision not to adopt the new framework this year. In early September, Deloitte fired a warning shot that when a company decides to stick with the expired framework for another year, an auditor should note that in his audit report.

Why would a company choose to delay COSO implementation another year? Deloitte's paper gives plenty of practical examples: you might not have reviewed your Code of Conduct lately; you might have weak ethics training for middle management; you might not monitor your third parties for adherence to anti-fraud controls. The list is long, from entity-level controls like a good Code of Conduct, to nitty-gritty functional items like mitigating controls for segregation of duties. If you want to panic effectively about all the work you need to do for a good COSO implementation, the Deloitte paper is an excellent place to start.

The Deloitte paper does say that most companies are proceeding with implementation this year, and even my exasperated compliance director above is forging ahead. I also believe that when you sit down and read the framework and associated guidance, and really ponder how to put it to use wisely—it's a strong document, and its principles do push the whole leadership team to think more smartly about ethical conduct, risk management, and internal control. But boy, you have to put a lot of time into thinking about how to use the framework, and that is one thing most senior leaders do not have.

I will add one shameless plug here: if you want to learn more about implementing the COSO framework, consider attending the Compliance Week West conference, happening Nov. 18, 2014, in San Francisco. We will bring together some great thought leaders on how to adopt the framework, including a keynote address from COSO Chairman Robert Hirth.



All Eyes on Internal Controls as Year-End Close Approaches

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it down yet, you should really focus on it and be aware that those questions are coming."

Recognizable Scrutiny

The PCAOB also warned auditors recently to dig in more on revenue recognition, with an alert in September telling auditors to look more closely at testing of revenue from contractual arrangements, evaluating gross vs. net presentation of revenue, testing whether revenue was recognized in the correct period, and evaluating revenuerelated disclosures. Companies are well aware that the Financial Accounting Standards Board issued a brand new standard for how to recognize revenue that doesn't take effect until 2017, but they might be less aware that auditors have been warned to look more closely at revenue recognition now under present standards, says Kelley Wall, a director at consulting firm RoseRyan. "I think it's going to come as a little bit of a surprise to them," she says. "The alert was directed to auditors, not to registrants. I think most companies are unaware that this is going to be a hot ticket item for year-end."

Chris Wright, managing director at Protiviti, says companies would be well advised to review their documentation around revenue recognition. "Companies may need to either fortify their present policy and position papers around revenue, or create them," he says. The silver lining: The effort now might prove insightful later in adopting the new standard as companies begin to prepare for that implementation, he says. "Anytime there's more documentation, you are in a better position to determine the proper accounting under the new rules."

In addition, companies should be prepared for questions from auditors about what they've done so far to prepare for the new standard, says Wendy Hambleton, national director at BDO USA focused on financial reporting issues. "It is not impacting the current audit, but in the future what direction will you be going?" she says. "Will you do a full or modified retrospective adoption? How does that affect your policies, your data, your systems? Auditors will want to know."

Another area of focus for auditors, although not necessarily new for 2014, is any accounting assertion that involves estimating or forecasting. "It could be contingent liabilities, a goodwill impairment analysis, fair value of accounting reserves—anything that requires estimates or judgment," says Wall. Auditors have heard plenty from the PCAOB to be more skeptical, demand more documentation, and do more testing around such areas. Companies need to show sound basis for their judgments, and they need to be applied consistently, she says. "Auditors are going to be pushing back more on those," she says.

Companies might also want to take a fresh look at their disclosures, says Robert Uhl, a partner with Deloitte & Touche. Securities and Exchange Commission staff speeches in recent months have focused not just on SEC initiatives to improve disclosures, but measures companies can take even ahead of any new rules that might be developed to improve their disclosures, says Uhl. "The focus is on making sure that disclosures are relevant and material, eliminating or reducing redundancies, tailoring disclosures to the company's specific circumstances, and eliminating boilerplate," he says.

Other items that may crop up include any asset and liability allocations associated with a business combination, says Wright, as merger and acquisition activity is picking up with the economy, and any large, subjective accruals. The SEC comment letter process is driving some scrutiny not only around the amounts of such accruals, but also the timing, he says.

Buying Time on COSO's Internal Control Framework

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sition at Crowe is you should do it now because you're running out of time," he says. "It's a great opportunity to take advantage of the new aspects of the framework from a risk management perspective, so why wait?"

One good reason for a delay, says Christensen, is if a company is in the midst of a significant merger or acquisition. "M&A activity has spiked up with a strong economy, so there are organizations going through sophisticated combinations," he says. Implementations of enterprise resource planning systems might also make it difficult to implement a new internal control framework simultaneously, he says. "Those are good reason, we believe, that indicate the control environment is in a state of change, so the focus is on getting that completed and continuing with the prior framework."

McGladrey isn't telling companies to take their time, but partner Sara Lord sees the movement and understands it. "There's some evidence out there saying you do need to do this and take it seriously," she says. "But there will be some companies that just don't make it through." Some are asking if the 1992 framework will suddenly become unsuitable to meet the reporting need just because the calendar flips to a new date, she says. "It's a logical question, so that would be an argument to be made," she says.

Mark Kultgen, another partner with McGladrey, says it's possible some companies won't get it done simply because they don't have the staffing capacity. "I have yet to see a company that doesn't want to migrate to the 2013 framework, but there is effort involved," he says.

Lord emphasizes if companies decide not to adopt the framework this year, it will be important to communicate it to auditors so they can test controls accordingly. "Our audit standard is such that we audit to the framework management is using," she says. "If they assert they are using the 1992 framework, we will audit to that. We can do that."

Mike Rose, a partner with Grant Thornton, says he's not hearing a word about any slowdown in adopting the new framework. "I'm seeing across the board full steam ahead," he says.



