The New *Internal Control—Integrated Framework*

Submitted by Myra L Byrd, Public Service Assistant
Carl Vinson Institute of Government
University of Georgia

The new *Internal Control—Integrated Framework* (IC-IF) was released by the Committee of Sponsoring Organizations (COSO) on May 14, 2013. This article helps to explain how the new document is structured and provides a limited comparison between the old and the new framework.

But, first, just who is COSO? ***COSO is:***

- The American Institute of Certified Public Accountants
- The American Accounting Association
- The Institute of Internal Auditors (IIA)
- The Institute of Management Accountants
- The Financial Executives Institute (FEI)

The National Commission on Fraudulent Financial Reporting, known as the Treadway Commission, was created in 1985 by the joint sponsorship of the AICPA, American Accounting Association, FEI, IIA and Institute of Management Accountants (IMA, formerly the National Association of Accountants). The Treadway Commission had as its major objective to identify the causal factors of fraudulent financial reporting and to make recommendations to reduce its incidence. The Commission's report, (Report of the National Commission on Fraudulent Financial Reporting -National Commission on Fraudulent Financial Reporting, 1987), issued in 1987, made a number of recommendations that directly addressed internal control. It emphasized the importance of the control environment, codes of conduct, competent and involved audit committees and an active and objective internal audit function. Additionally, the Commission called for the sponsoring organizations to work together to integrate the various internal control concepts and definitions, and to develop a common reference point. It was suggested that this guidance would help all organizations improve their internal control systems, and help judge their effectiveness.

Based on this recommendation, a task force under the auspices of the Committee of Sponsoring Organizations of the Treadway Commission conducted a review of internal control literature. The results, published by the IMA, recommended that the sponsoring organizations undertake a project to provide practical, broadly accepted criteria for establishing internal control and evaluating its effectiveness. The task force recommended that the criteria be directed toward the needs of management, since management has the primary responsibility for establishing, monitoring, evaluating and reporting on internal control. However, it suggested that the criteria should be developed through a process that would result in their acceptance by other groups having a significant interest in internal control, including internal and external auditors, educators and regulatory bodies. Internal Control - Integrated Framework is a result of that recommendation.

Since the release of the original *Internal Control—Integrated Framework* in 1991, the definition of internal control has been widely accepted by the accounting and auditing professions both governmental and nongovernmental. The new *Internal Control—Integrated Framework* did not change that definition.

The basic structure of the framework is also unchanged. COSO still believes internal control is made up of five components: the control environment, risk assessment, control activities, information and communication, and monitoring activities. And COSO is still stressing the need for management's judgment for creating and assessing an effective system. But COSO is now offering additional factors for management to consider when making assessments, including the ability of the organization to implement broader controls to strengthen its internal-control system and prevent fraud.

One of the major differences between the updated IC-IF and the original document is the use of a principles-based approach. The updated *Framework* focuses greater attention on principles by expressly stating 17 principles divided amongst the five interrelated components. These principles are broad as they are intended to apply to many different types of organizations. Supporting the 17 principles are 56 attributes, representing characteristics of the principles. Together, the principles and attributes comprise the criteria that should assist management in assessing whether an entity has effective internal control.

Another change from the 1992 version of the IC-IF is that the newly updated *Framework* expands the reporting category of objectives. While the three categories of objectives (operations, financial reporting and compliance) have not changed, the financial reporting objective has expanded to consider other external reporting beyond financial reporting, as well as internal reporting, both financial and non-financial.

The relationship between fraud and internal control, while less noticeable in the 1992 version, has taken a role of prominence in the updated *Framework*. The updated version considers the potential for fraud as one of the four principles of internal control included in the risk assessment component. The principle in the draft proposal of the updated *Framework* requires the organization to consider the potential for fraud in assessing risks to the achievement of objectives. In addition, this potential-for-fraud principle includes five attributes to assist management in assessing whether the internal controls are effective as they relate to the consideration of fraud.

In conclusion, while the definition of internal control and the basic structure of the framework remain unchanged, the new principles and attributes offered in the updated *Framework* should enhance the understanding of an effective interrelated internal control system and assist management in assessing the effectiveness of their organization’s system.