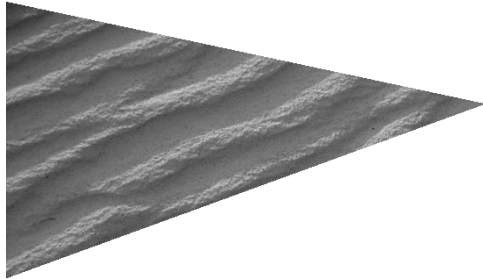


# A New Era in Internal Controls: “Implementing the New COSO Internal Controls Integrated Framework”

Greek Shipping Forum  
24 February 2014



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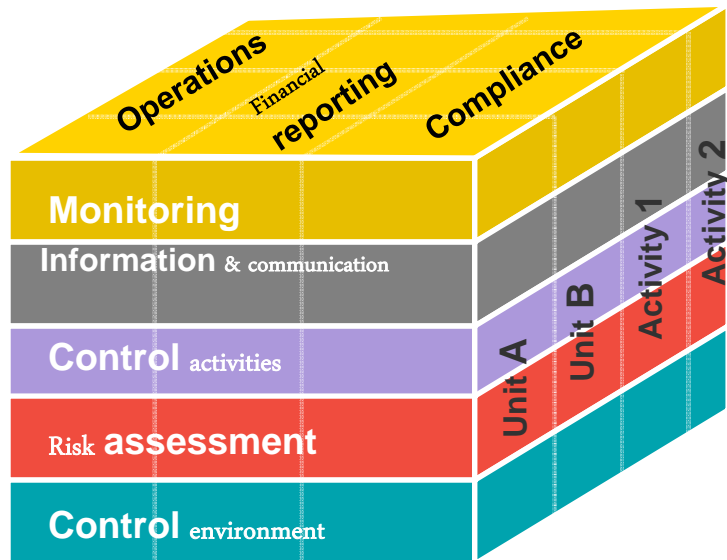
# Agenda

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- Internal Control - COSO Integrated Framework
- Why the update?
- Key changes in the Framework
- Codification of 17 principles and point of focus areas
- Transition and impact
- Where to go from here – a way forward
- A few common questions
- Questions

# Internal control - COSO integrated framework

- First published in 1992
- Gained wide acceptance following financial control failures of early 2000s
- Most widely used framework in the United States and around the world



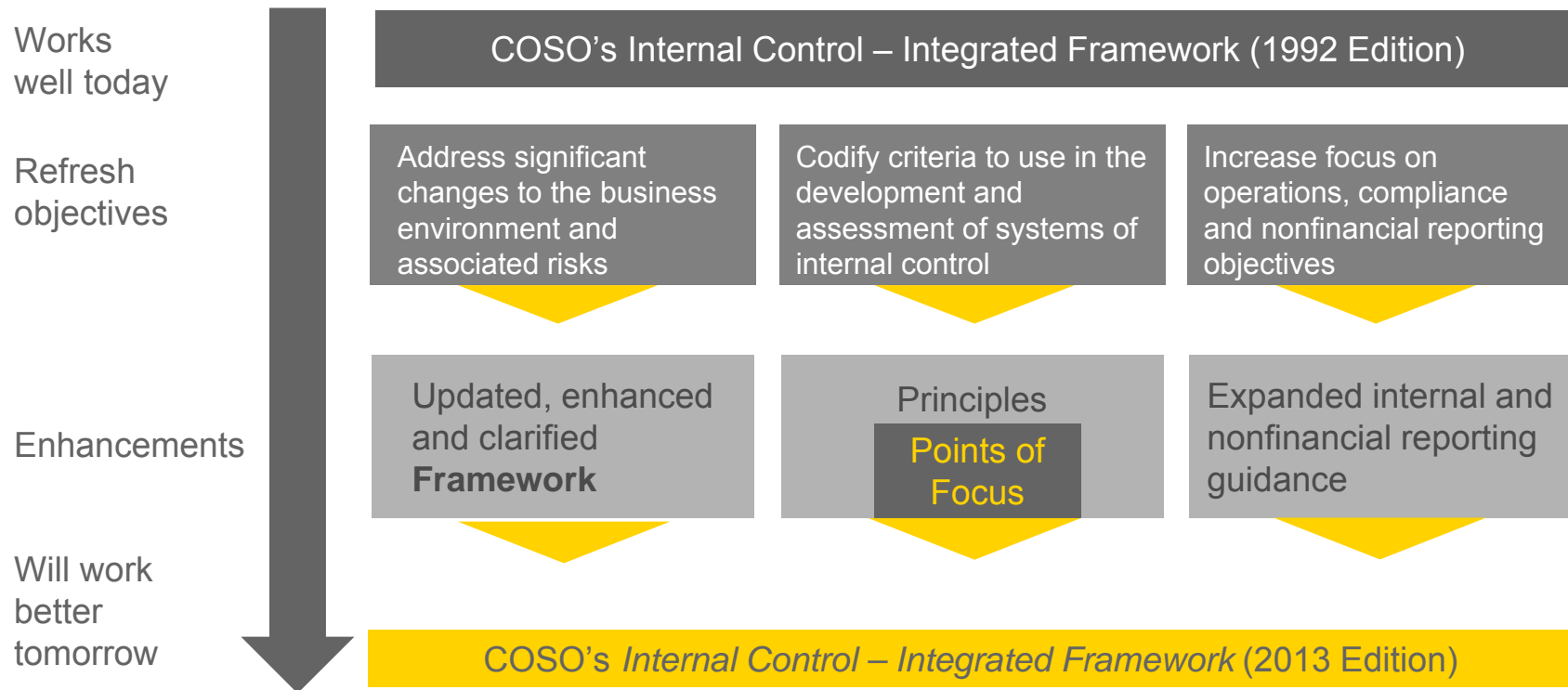
COSO Cube (1992 Edition)



COSO Cube (2013 Edition)

# Why the update?

- Business and operating environments have changed dramatically, becoming increasingly complex, technologically driven and global in scope.
- Stakeholders are more engaged, seeking greater transparency and accountability for the integrity of systems of internal controls that support business decisions and governance.



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# Key Changes in the Framework

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- **General enhancements:**
  - Updated, enhanced and clarified framework to address changes in the business and operating environments
  - Expanded financial reporting category of objectives to include other important forms of reporting, such as nonfinancial and internal reporting
  - Formalizes as principles concepts underlying effective internal control
- **Clarifies requirement for effective internal control:** An effective system of internal control reduces, to an acceptable level, the risk of not achieving an objective relating to one, two, or all three categories of objectives - that is, operations, reporting, and compliance. It requires that (1) each of the five components of internal control and relevant principles are present and functioning, and that (2) the five components are operating together in an integrated manner.
- **Principles-based approach:** While the 1992 version implicitly reflected the core principles of internal controls, the 2013 version explicitly states 17 principles that represent the concepts associated with each of the five components. The new framework presumes that all 17 principles must be present and functioning in an effective system of internal control.
- **Present and functioning:** Present refers to the determination that components and relevant principles exist in the design and implementation of the system of IC. Functioning refers to the determination that they exist in the operation and conduct of the system of internal control.
- **Points of focus:** Developed to help management design, implement, conduct and assess whether relevant principles are present and functioning

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# Key Changes in the Framework (continued)

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- **Clarifies the role of objective-setting in internal control:** The 2013 version preserves the view that objective-setting is a management process, but further clarifies the role of objective setting in internal control.
- **Reflects the increased relevance of technology:** Technologies have evolved from large standalone mainframe environments to highly sophisticated, decentralized, and mobile applications involving multiple real-time activities that can cut across many systems, organizations, processes and technologies. The change can impact how all components of internal control are implemented.
- **Enhances governance concepts:** The 2013 version includes expanded discussion on governance relating to the board of directors and committees of the board, including audit, compensation and nomination/governance committees.
- **Expands the reporting category of objectives:** The financial reporting objective category is expanded to consider other types of reporting such as nonfinancial and internal reporting.
- **Enhances consideration of anti-fraud expectations:** This 2013 version contains considerably more discussion of fraud and also considers the potential for fraud as a principle of internal control.
- **Considers different business models and organizational structures:** Entities now expand their business models to further encompass the use of external parties.

# Codification of 17 principles

**Principles-based approach:** The principles are the fundamental concepts associated with the components of internal control. It is generally expected that all principles will, to some extent, be present and functioning for an organization to have effective internal control. When a principle is not being met, some form of internal control deficiency exists.

1. Control Environment	<ol style="list-style-type: none"> <li>1. Organization demonstrates commitment to integrity and ethical values</li> <li>2. Board of Directors is independent from and management and exercises oversight</li> <li>3. Management, with Board oversight, establishes structure, authority and responsibility</li> <li>4. Organization demonstrates commitment to competence</li> <li>5. Organization establishes and enforces accountability</li> </ol>	Principles in the framework
2. Risk Assessment	<p>Organization:</p> <ol style="list-style-type: none"> <li>6. Specifies relevant objectives with sufficient clarity to enable identification of risks</li> <li>7. Identifies and assesses risk</li> <li>8. Considers the potential for fraud in assessing risk</li> <li>9. Identifies and assesses significant change that could impact system of internal control</li> </ol>	
3. Control Activities	<p>Organization:</p> <ol style="list-style-type: none"> <li>10. Selects and develops control activities</li> <li>11. Selects and develops general controls over technology</li> <li>12. Deploys controls through policies and procedures</li> </ol>	
4. Information & Communication	<p>Organization:</p> <ol style="list-style-type: none"> <li>13. Obtains or generates relevant, quality information</li> <li>14. Communicates internally</li> <li>15. Communicates externally</li> </ol>	
5. Monitoring	<p>Organization:</p> <ol style="list-style-type: none"> <li>16. Selects, develops and performs ongoing and separate evaluations</li> <li>17. Evaluates and communicates deficiencies</li> </ol>	

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# Point of focus areas

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- ▶ For example

## Control environment

1. The organization demonstrates a commitment to integrity and ethical values.

### *Points of focus:*

- Sets the tone at the top
- Establishes standards of conduct
- Evaluates adherence to standards of conduct
- Addresses deviations in a timely manner

- ▶ Points of focus may not be suitable or relevant, and others may be identified
- ▶ Points of focus may facilitate designing, implementing and conducting internal control
- ▶ There is no requirement to separately assess whether points of focus are in place.



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# Transition and impact

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- ▶ Transition applications and related documentation to the updated Framework as soon as feasible – should be well underway
  
- ▶ Updated Framework will supersede original Framework at the end of the transition period (i.e. 15 December 2014)
  
- ▶ During the transition period, entities reporting externally should disclose whether the original or updated version of the Framework was used
  
- ▶ Impact of adopting the updated Framework will vary by organization
  - ▶ Does your system of internal control need to address changes in business?
  - ▶ Does your system of internal control need to be updated to address all principles?
  - ▶ Does your organization apply and interpret the original framework in the same manner as COSO?
  - ▶ Is your organization considering new opportunities to apply internal control to cover additional objectives?

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# Where to go from here - a way forward

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1.

Ongoing dialogue with Senior Management and Audit Committee on the new Framework, highlighting its key changes, implications for the system of internal control and progress in transition

2.

Review, establish and execute a process for identifying and assessing necessary changes in controls (if any) and related documentation

3.

Document your approach for applying the new COSO framework and your transition plan, including changes in controls and related documentation

Given the integral role management, the Audit Committee, internal audit and other risk management functions all play in an effective system of internal control, a coordinated approach to address the key changes in the new COSO framework is essential.

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# Where to go from here - a way forward (continued): Transition documentation

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- A** Review existing internal control assessment results and **perform an overall assessment** with respect to the five components and supporting 17 principles.
- B** **Evaluate each of the five components** individually and collectively, and document (in summary) whether the relevant principles are present and functioning.
- C** For each component, **formally evaluate whether each of the 17 principles** (to the extent they are relevant) are present and functioning and document the summarized assessment, including any deficiencies/gaps.
- D** Create a **detailed mapping of all internal controls** to each of the five components and related principles and document (may not be required if A,B and C above can be adequately supported)
- E** **Identify additional controls (if any)** that may be relevant to fully support a component and/or principle to be present and functioning in the design and implementation of the system of internal control.
- F** **Update internal control documentation** to reflect changes in the new COSO framework, including but not limited to: financial and nonfinancial reporting (both internal and external), documenting whether the 17 principles are present and functioning, and clarifying the objectives: (1) effectiveness and efficiency of operations, (2) compliance with regulatory requirements and (3) reporting.

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# Where to go from here - a way forward (continued): Assessment and Internal Audit

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## Management's assessment:

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**G**

Update management's control self-assessment process to include the three objectives (as part of risk assessment), the five components and the 17 principles (as part of self-assessment questionnaires)

**H**

Update risk-assessment methodology (as applicable) and documentation to include an evaluation of the three objectives, five components and 17 underlying principles

## Internal Audit:

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**I**

Revise the IA risk-assessment methodology to address the 17 principles supporting the five components for achievement of the three objectives

**J**

Refer to the 17 principles in assurance reviews performed by internal audit and IA's communication to senior management and the audit committee

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# A few common questions

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- ▶ **What will SEC registrant preparers need to do differently?**

SOX filers should update their internal control documentation supporting the application of the revised framework.

- ▶ **Is it mandatory to make these changes?**

COSO will consider the 1992 framework superseded by the 2013 framework as of 15 December 2014. COSO believes continued use of the 1992 framework during the transition period is appropriate. The SEC staff has indicated flexibility, but it will question issuers the longer the 1992 framework continues to be used.

- ▶ **Is the old framework still relevant?**

The old framework can be used during the transition period. Companies that make public assertions during the transition period about the effectiveness of their internal controls are required to disclose which framework was used in the assessment.

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# A few common questions (continued)

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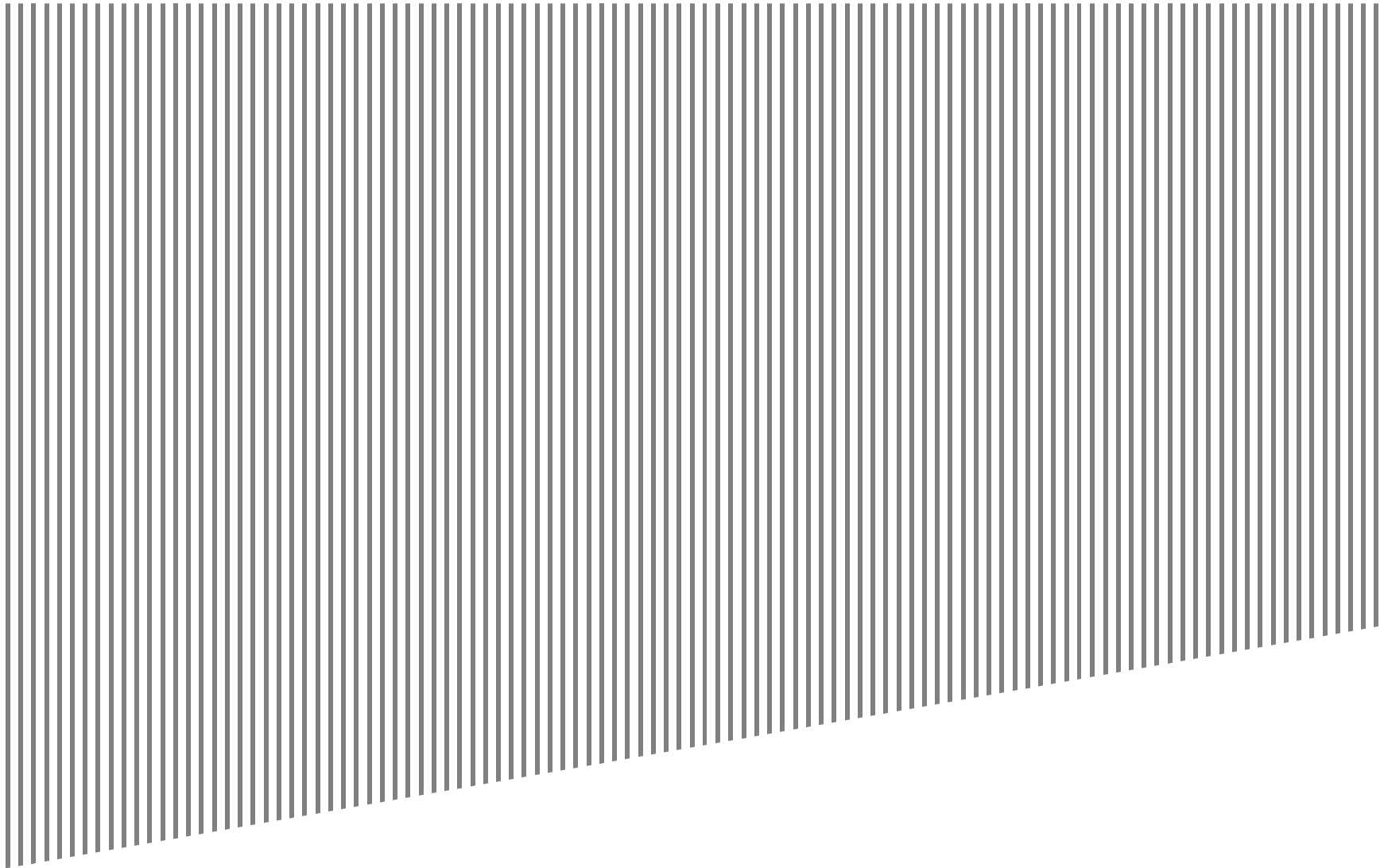
▶ **Should we use the compendium and illustrative tools?**

The compendium of illustrative tools is guidance provided by COSO to help organizations apply the new framework. It is not mandatory, but is one of several ways in which organizations can design and implement the system of internal control. Please refer to page 10 for more ideas on how to apply the new COSO framework to your system of internal control.

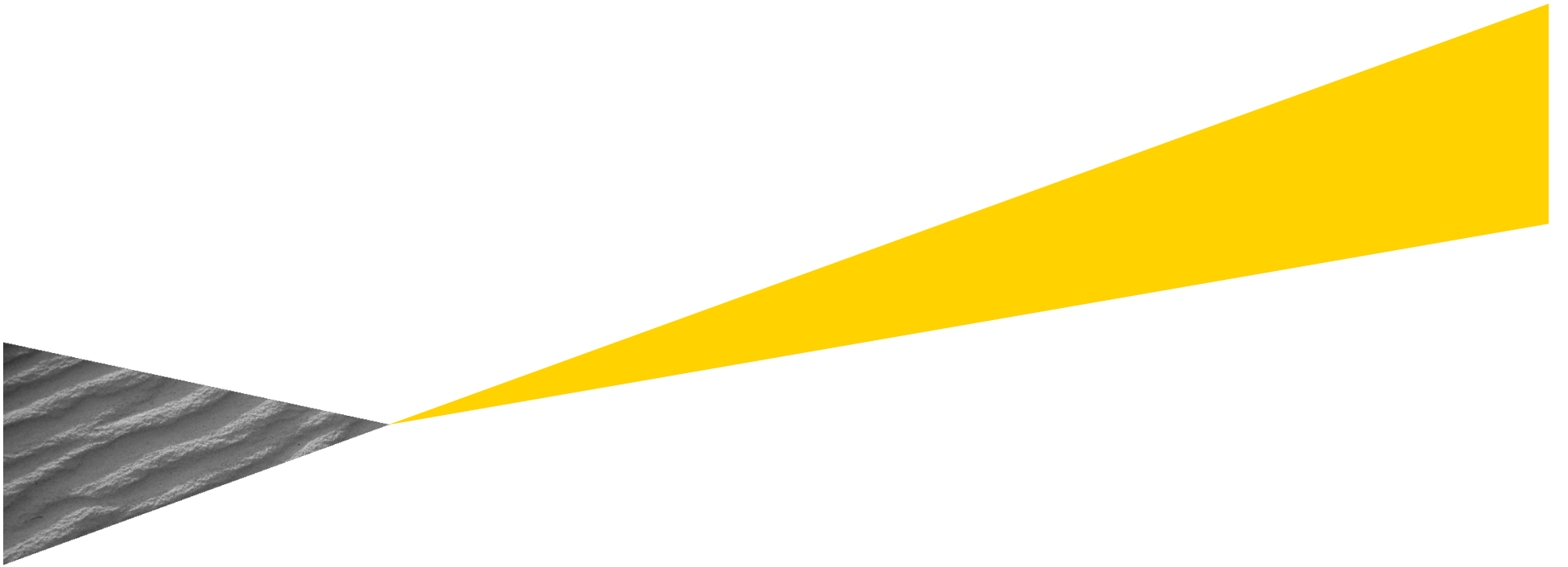
▶ **How does it link with the Engagement Risk Management?**

Enterprise Risk Management is much broader than internal control. The COSO ERM framework and guidance are still valid. Internal control is, and will continue to be an integral part of the ERM framework.

# Questions?



Thank you



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