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United States Government Accountability Office  
Washington, DC 20548

December 4, 2012

Mr. David L. Landsittel, Chair  
The Committee of Sponsoring Organizations of the Treadway Commission

Subject: Committee of Sponsoring Organizations of the Treadway Commission (COSO) September 2012 Exposure Draft (ED) of *Internal Control-Integrated Framework* and ED of *Internal Control over External Financial Reporting: A Compendium of Approaches and Examples*

Dear Mr. David L. Landsittel,

This letter provides the U.S. Government Accountability Office's (GAO) comments on the exposure drafts of COSO's *Internal Control – Integrated Framework* (Integrated Framework) and *Internal Control over External Financial Reporting: A Compendium of Approaches and Examples* (Compendium) issued in September 2012.

GAO continues to support COSO and the Integrated Framework and is in agreement with COSO that internal controls are integral and should be built into an organization's management and operations. We commend the work that COSO has completed on this update to the Integrated Framework and the revisions that have been made to address comments received during the first public exposure period.

Enclosure 1 contains our comments on the latest draft of the Integrated Framework. Our comments primarily relate to the applicability of the Integrated Framework to various types of organizations, including governments, as well as consistent use of terminology. In our comments, we indicate how we believe the guidance could be improved, along with our specific recommendations in the following areas:

- Revise the phrase “present and functioning”
- Continue use of the term “attributes”
- Revise the operations objective example for government

- Include examples of internal control deficiencies for operations and compliance objectives
- Define “major deficiency” when it is first used
- Revise language used in classifying deficiencies for consistency
- Include the objectives of confidentiality and availability of data
- Include the broader concepts of fair presentation and/or true and fair view
- Include a section to discuss the monitoring of corrective actions
- Improve general applicability of the COSO Integrated Framework to all entities
- Emphasize safeguarding assets

While our comments focus on the revised draft of the Integrated Framework, we suggest that corresponding revisions be made to the Compendium, where appropriate.

We thank you for considering our comments on these important documents as we work together on issues of mutual interest. Please contact me at 202-512-3133 or [dalkinj@gao.gov](mailto:dalkinj@gao.gov) if you want to discuss any of our comments or need further information.

Sincerely yours,

A handwritten signature in black ink, appearing to read "James R. Dalkin". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

James R. Dalkin  
Director  
Financial Management and Assurance

## **Enclosure 1**

### **Revise the phrase “present and functioning”**

The terms “present” and “functioning” as applied to components and principles in paragraph 90 appear to be similar to the terms “design and operating effectiveness” as used in Government Auditing Standards (GAGAS).

### **Recommendation**

We recommend that the terms “present” and “functioning” as applied to components and principles be replaced with the term “design and operating effectiveness” to maintain consistency of terminology within internal control guidance.

### **Continue use of the term “attributes”**

While we acknowledge the reason given for revising the term “attributes” to be “points of focus,” we do not believe that the use of different terminology is needed. The same result could be achieved through the revised discussion of principles and the relocation of the discussion of “attributes” to Additional Considerations in chapter 4, as was done with “points of focus.” Alternatively, we suggest using the term “characteristics.”

### **Recommendation**

We recommend that the term “attributes” continue to be used to describe the important characteristics of principles.

### **Revise the operations objective example for government**

The example of an operations objective provided for a governmental agency in paragraph 47 is actually an example of a compliance objective. It discusses executing spending in line with the designated purposes of appropriators, which would typically be a matter of compliance with law.

### **Recommendation**

We suggest revising paragraph 47 to focus more on the operations objectives of the agency, as follows:

“A governmental agency may focus on achieving the mission established for it by the legislature or governing body, through effective and efficient management of the specific government program primarily on executing its spending in line with the designated purposes of its appropriators to ensure that the spending supports its mission objectives.”

### **Include examples of internal control deficiencies for operations and compliance objectives**

The discussion that included examples of internal control deficiencies for financial, operations, and compliance objectives was removed from the previous draft of the

Integrated Framework. While the examples for operations and compliance objectives were part of the deleted discussion of “major” and “minor non-conformities,” we believe that they provided good context for understanding internal control deficiencies for those types of objectives. While there is extensive additional guidance regarding internal control deficiencies for financial reporting available outside of the Integrated Framework, that type of guidance is not readily available for operations and compliance objectives.

### **Recommendation**

We suggest adding back to the Integrated Framework the discussion of internal control deficiencies for operations and compliance objectives that were originally included in the previous draft of the Integrated Framework, modified for the removal of the terms “major” and “minor non-conformities,” as needed.

### **Define “major deficiency” when it is first used**

The term “major deficiency” is used several times, in paragraphs 87, 92, 95, and 100, prior to being defined in paragraph 102. By using the term before it is defined, readers may not understand the full implications of the earlier discussions.

### **Recommendation**

We suggest reorganizing the section on Effective Internal Control, so that the term “major deficiency” is defined when it is first used.

### **Revise language used in classifying deficiencies for consistency**

While we agree with using consistent terminology to discuss internal control deficiencies for all types of objectives, we believe the terminology should be consistent with that used to discuss internal control deficiencies by other standard-setting organizations and regulators. Specifically, we believe the terms “material weakness” and “significant deficiency” should be used with respect to control deficiencies. Such terms are in common usage and, consequently, we believe that such terms effectively convey the relative severity of control deficiencies. This terminology is familiar to most users already and is also logical to those who are not already familiar with it. Inconsistent terminology may lead to inconsistent application of the Integrated Framework in practice.

The federal government has used consistent terminology to categorize all types of control deficiencies for many years, and we believe that it has provided a consistent frame of reference for users to evaluate the significance of reported deficiencies in internal control. We recognize that using the terms “material weakness” and “significant deficiency” would require expanding the definition of the terms to address controls over operations and compliance, but believe that it could be readily accomplished.

**Recommendation**

We recommend that the terms “material weakness” and “significant deficiency” be used for classifying internal control deficiencies for all three categories of internal control objectives.

**Include the objectives of confidentiality and availability of data**

We believe that the two additional objectives related to confidentiality and availability are also relevant and should be included in the Framework. Controls over confidentiality are important to protect the confidentiality of personal information and to comply with various privacy and data breach laws, as well as to consider the potential risks or implications to an entity if personal information maintained by the entity is breached. Also, controls over availability are important to reasonably ensure that there is timely access to information. In the absence of controls related to availability, information and systems may be unavailable when needed.

**Recommendation**

We recommend that the two objectives related to confidentiality and availability should be included in the Framework to protect the confidentiality of personal information, to comply with various privacy and data breach laws, as well as to reasonably ensure that there is timely access to information.

**Include the broader concepts of fair presentation and/or true and fair view**

The External Financial Reporting Objectives “Points of Focus” discussion at paragraph 245 discusses compliance with applicable accounting standards, but does not appear to discuss fair presentation and/or true and fair view which are broader concepts for which financial reporting controls should exist.

**Recommendation**

We recommend that the External Financial Reporting Objectives “Points of Focus” discussion at paragraph 245 discuss the concepts of fair presentation and/or true and fair view to identify the broader concepts for which financial reporting controls are established.

**Include a section to discuss the monitoring of corrective actions**

The points of focus listed in paragraph 467 includes “Monitors Corrective Actions” as a point of focus for the evaluation and communication of deficiencies, but does not have a subsequent section discussing the activities used by management to determine whether deficiencies are remediated in a timely basis.

**Recommendation**

We recommend that the point of focus for the evaluation and communication of deficiencies include a section that discusses examples of monitoring activities used by management to determine whether deficiencies are remediated in a timely basis. This section on monitoring would provide guidance to help management determine

whether deficiencies are remediated in a timely basis, and align with the other points of focus listed in paragraph 467 that include sections that subsequently discuss the assessing results and communicating deficiencies.

**Improve general applicability of the COSO Integrated Framework to all entities**

We continue to believe that terminology should be sector neutral to reflect the broad range of users of the COSO Integrated Framework, including government, small businesses, and not-for-profit entities. For example, terms such as “board of directors” or “chief executive officer” may not be applicable to all users of the Framework and should be replaced by or appended with terms such as “those charged with governance” and “head of the organization,” respectively.

Another reason for sector neutrality in the COSO Integrated Framework is to enhance consistency with complementary internal control standards. GAO is responsible for issuing internal control standards for the federal government and has issued *Standards for Internal Control in the Federal Government* (GAO/AIMD-00-21.3.1, November 1999). Our last revision to the standards in 1999 was based on the 1992 version of COSO’s *Internal Control—Integrated Framework*. We believe that it is critically important to have consistent standards for internal control where appropriate, while recognizing that some differences may exist. We believe that many of the principles and characteristics described in COSO’s Integrated Framework will be helpful for understanding and implementing internal control in government. Sector neutrality in the COSO Integrated Framework would contribute greatly to better consistency between the COSO Integrated Framework and *Standards for Internal Control in the Federal Government*.

**Recommendation**

We recommend modifying the Integrated Framework to include terms that are applicable to all types of entities.

**Emphasize safeguarding assets**

We continue to believe that the Integrated Framework should be revised to more clearly emphasize that safeguarding assets is a subset of all three categories of objectives for internal control. The current draft of the Integrated Framework retains the position that safeguarding assets is an operations objective of internal control, which can be viewed within the context of reporting and compliance objectives.

**Recommendation**

We recommend that the Framework clearly state in the discussion of the categories of internal control objectives that safeguarding assets is a subset of the three categories of internal control objectives.