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Mr. James Dalkin
Director, Financial Management and Assurance
Government Accountability Office (GAO)

RE: Proposed Standards for Internal Control in the Federal Government

Dear Mr. Dalkin:

We appreciate the opportunity to respond to the Government Accountability Office (GAO) Exposure Draft, *Standards for Internal Control in the Federal Government* (ED) (currently commonly referred to as the Green Book). We acknowledge GAO's commitment to internal control for the federal government and the efforts put forth to develop the ED. The importance of internal control in the federal government is highlighted in many statutes and regulations, such as the Federal Managers' Financial Integrity Act of 1982 (FMFIA) and Office of Management and Budget Circular No. A-123, *Management's Responsibilities for Internal Control*, (OMB Circular No. A-123) and the Green Book will serve as a tool to elevate internal control to the next level within the federal government.

In the "Enclosure I: Summary of Major Changes," GAO indicates it adapted the revised Committee of Sponsoring Organizations of the Treadway Commission's (COSO) *Internal Control: Integrated Framework* (2013 COSO Framework) when developing the ED. In a September 2013 GAO Podcast, *An Overview of GAO's Green Book Standards for Internal Controls*, GAO stated that it harmonized/converged the ED with the 2013 COSO Framework. However, we believe there are four main areas whereby the ED does not harmonize with the 2013 COSO Framework.

1. Developing Standards for Internal Control rather than a Framework for Internal Control

The existing Green Book (1999), while referred to as a standard, is at a high-level and considered by many within the federal industry as a "framework" for internal control that is used by management in conjunction with OMB Circular No. A-123 and GAO's *Internal Control Management and Evaluation Tool*. In addition, the 2013 COSO Framework is a "framework" and as such provides the basic structure for applying a principles-based approach for an organization to establish an effective system of internal control at any type of entity to achieve any objective deemed important to the organization.

GAO indicates that the Green Book will provide "standards" for internal control in the federal government rather than a "framework" for internal control. This distinction is important, and it represents more than a harmonization/convergence with the 2013 COSO Framework. As discussed in the "How to Use the Green Book" section, the ED contains "musts" and "shoulds", which create specific requirements that are not present in the 2013 COSO Framework.

Although the ED refers to "standards/criteria" for internal control in the federal government and includes "musts" and "shoulds", we believe that the distinction between a "framework" and "standards" is not clear within the ED and may not be understood by the intended users. Specifically, "Enclosure II: Questions for Commenters" includes a question that asks, "Does the *framework* provide the necessary

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information to allow program managers to evaluate the internal controls for their programs?” Further the second paragraph of the “Foreword” states that the ED provides the overall *framework* for establishing and maintaining an effective internal control system, while OMB Circular No. A-123 provides the specific requirements for assessing and reporting on controls in the federal government. We recommend that if it is GAO’s intention for the Green Book to provide “standards” as opposed to a “framework”, the term “framework” should be removed throughout the document. Further, we believe GAO should clearly explain in the Foreword that the Green Book is considered a “standard” and describe how this is different from a “framework” such as the 2013 COSO Framework. Lastly, as the “Forward” states that OMB Circular No. A-123 provides specific requirements for assessing and reporting on controls, it is unclear how the standards for effective internal control in the Green Book will be harmonized with the existing OMB Circular No. A-123.

GAO indicates that the Green Book may be useful to state, local, quasi-governmental entities and not-for-profit organizations. The third paragraph of the Foreword states (items bolded for emphasis):

The Green Book may also be applied by state, local, and quasi-governmental entities, as well as not-for-profit organizations, as a **framework** for an internal control system. Management of these entities determines, based on applicable laws and regulations, how to appropriately **adapt the framework** presented in the Green Book for an entity.

If the Green Book is intended to be a standard, then other organizations, such as those mentioned above, cannot adapt it and still meet all of the “musts” and “shoulds”. In other words, management cannot adapt a standard and still claim to have met the standard. Until last month we would have recommended that if the Green Book is considered a standard, GAO should delete this paragraph. However, the recent issuance by OMB of the *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (OMB Uniform Guidance) with its requirement for non-federal entities to establish and maintain effective internal control with references to the Green Book and the COSO Framework has put non-federal entities in the position of potentially adapting. Therefore, GAO needs to clarify how these entities can adapt a standard.

2. Changing the Definition of Internal Control

There currently exists a definition of internal control that is the backbone of all standards/frameworks related to internal control. Paragraph O1.01, titled “Definition of Internal Control,” provides a definition of internal control, which is different from the definition used in the 2013 COSO Framework, AU-C 315, *Understanding the Entity* (AICPA Professional Standards), AS 5, *An Audit of Internal Control Over Financial Reporting* (PCAOB Professional Standards), ISA 315, *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment* (IAASB Professional Standards), and OMB Bulletin No. 14-02, *Audit Requirements for Federal Financial Statements* as follows:

ED (O1.01):

Internal control is an integral component of an entity’s management that provides reasonable assurance that the objectives of an entity are being achieved.

2013 COSO Framework:

Internal control is a **process**, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance.

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AU-C 315:

Internal control is a **process** effected by those charged with governance, management, and other personnel that is designed to provide reasonable assurance about the achievement of the entity's objectives with regard to the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.

AS 5:

Internal control is a **process** designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP.

ISA 315:

Internal control is the **process** designed, implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.

OMB Bulletin No. 14-02:

Internal Control is a **process** effected by those charged with governance, management, and other personnel that is designed to provide reasonable assurance about the achievement of the entity's objectives with regard to the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.

The key aspect of the COSO/AICPA/PCAOB/IAASB/OMB definitions of internal control is that internal control is a process. While the ED does refer to internal control as a process in the first paragraph of "How to Use the Green Book" and in paragraph O1.05, paragraph O1.01, titled "Definition of Internal Control," refers to internal control as a component of an entity's management. We do not believe internal control should be considered a component of an entity's management. Lastly, the "Glossary" of the ED provides another definition of internal control that is different from paragraph O1.01 as well as the COSO/AICPA/PCAOB/IAASB/OMB definitions of internal control, as follows:

Internal Control (Glossary):

The plans, methods, policies, and procedures used to fulfill the mission, strategic plan, goals, and objectives of the organization.

Providing multiple definitions for internal control in the Green Book that are different from widely understood and accepted definitions will cause confusion and inconsistency in the application of the standard and therefore, we recommend adjusting the definition of internal control in the ED to match the definition used by COSO and other auditing standards setters.

The confusion resulting from using the definition in paragraph O1.01 is highlighted by replacing "management" in the ED's definition of internal control with the definition of management from the ED.

Definition of Management (O2.14):

Entity personnel who are directly responsible for all activities of an organization, including the design, implementation, and operating effectiveness of an entity's internal control system.

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Definition of Internal Control (O1.01) (re-written with definition of management):

Internal control is an integral component of *entity personnel who are directly responsible for all activities of an organization, including the design, implementation, and operating effectiveness of an entity's internal control system* that provides reasonable assurance that the objectives of an entity are being achieved.

Similar confusion results by replacing “internal control” in the definition of a deficiency with the definition of internal control from the ED.

Definition of a Deficiency (O3.03):

A deficiency in internal control exists when the design, implementation, or operation of a control does not allow management or personnel, in the normal course of performing their assigned functions, to achieve control objectives and address related risks.

Definition of a Deficiency (re-written with the definition of internal control from O1.01):

A deficiency in an *integral component of an entity's management that provides reasonable assurance that the objectives of an entity are being achieved* exists when the design, implementation, or operation of an *integral component of an entity's management that provides reasonable assurance that the objectives of an entity are being achieved* does not allow management or personnel, in the normal course of performing their assigned functions, to achieve control objectives and address related risks.

3. Changing the Seventeen Principles

Principles for internal control provide the roadmap for management to follow to implement and maintain effective internal control. The ED includes seventeen principles as does the 2013 COSO Framework. However, the wording of the principles in the ED is different from that used in the 2013 COSO Framework. While we recognize that GAO's intention to make this a standard will result in the use of “shoulds” and that the governance structure of a federal entity may necessitate other adjustments to the principles, the differences in the principles go beyond that of the word “should” and the necessary adjustments due to the governance structure and in many cases do not appear to be necessary or an improvement over the wording used in the 2013 COSO Framework.

In some instances, we believe the adjustments completely change the meaning of a stated principle. For example, the changes made to principle nine significantly change the meaning and as a result the goal of the principle.

2013 COSO Framework (Principle Nine):

The organization identifies and assesses changes that could significantly impact the system of internal control.

ED (Principle Nine):

Management should identify, analyze, and respond to significant changes in the internal control system.

Under the 2013 COSO Framework, the organization should identify and assess changes throughout the organization that would impact the internal control system and then as a result consider if changes to the internal control system are necessary. However, under the ED, management should identify changes in the internal control system and analyze/respond to the changes. We believe this is a fundamental difference in the principle because one (2013 COSO Framework) requires identifying changes throughout

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the organization that would impact the system of internal control while the other (ED) only requires the identification of changes in the internal control system. Principle nine within the 2013 COSO Framework is “proactive” while principle nine in the Proposed Green Book is “reactive”. We believe that a “proactive” principle is more effective in ensuring an entity maintains an effective internal control system.

Therefore, instead of adjusting the principles, we recommend that GAO maintain the 2013 COSO Framework principles and simply use the attributes to expand upon the different application of those principles in the federal government environment. However, if it is determined that the wording for some of the principles needs to be modified in the Green Book we recommend that GAO clearly articulate those areas that are different in the federal environment, other than the governance structure, that necessitate a change to the wording used in the 2013 COSO Framework.

Every word in a standard has a meaning and every variation in the wording should have a reason. While we have described one of the seventeen principles with variations from the 2013 COSO Framework above (Principle Nine), we have not provided detailed comments on the other sixteen principles or underlying attributes, which also contain changes from the 2013 COSO Framework.

4. Changing the Requirements for an Effective Internal Control System

A goal of a standard/framework for internal control is to provide criteria to follow to achieve effective internal control. As a result, a clear definition of effective internal control is imperative. Paragraph O3.01, of the ED, states that an effective internal control system requires that each of the five components, seventeen principles, and relevant attributes of internal control are effectively designed, implemented, and operating and the five components are operating together in an integrated manner. In addition, paragraph O3.09 states, “the Green Book describes each attribute in general terms. For each attribute, management considers the elements underlying the attribute and whether controls are properly designed, implemented, and operating effectively to achieve each element of the attribute. **If one or more of the elements are not achieved, then a deficiency in internal control exists.** As a result, we believe that to evaluate the internal control system, management will need to go further than what is stated in paragraph O3.01, and also consider and evaluate each element of an attribute associated with each principle.

The 2013 COSO Framework (Section 3, “Effective Internal Control”) requires that each of the five components of internal control and relevant principles is present and functioning and the five components are operating together in an integrated manner. The ED includes “and relevant attributes” and through paragraph O3.09 the “elements of the attributes”, while the 2013 COSO Framework does not include the corresponding level of “relevant points of focus” as requirements to achieve an effective internal control system. Therefore, the requirements for an effective internal control system appear to be more stringent in the ED to achieve an effective internal control system than that required by the COSO 2013 Framework. If GAO believes that the benefits of the more stringent requirements outweigh the costs of maintaining and evaluating internal controls to the level of the attributes, we believe that GAO should explain at paragraph O3.01 that this is a more stringent requirement than that of the 2013 COSO Framework.

Lastly, as the relevant attributes are required to achieve effective internal control, we identified two attributes that we believe are too vague to allow for the consistent implementation. These attributes, included in paragraphs 16.12 and 17.07, refer to evaluating, monitoring, and remediating internal control “issues.” The ED does not define what management (or the auditor) should consider as an internal control

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“issue”. We believe that these attributes are intending to refer to internal control deficiencies, and as a result, we provide the following revision to paragraphs 16.12 and 17.07 (new content underscored; deleted content strike-through):

16.12 Management should evaluate and document the results of ongoing monitoring and separate evaluations to identify internal control deficiencies~~issues~~.

17.07 Management should evaluate and document internal control deficiencies ~~issues~~ and determine appropriate corrective actions for internal control deficiencies on a timely basis.

* * * *

If, however, it is GAO’s intention for the Green Book to be a “framework” for internal control in the federal government instead of a “standard”, we recommend that GAO adopt, instead of adapt, the principle and points of focus of the 2013 COSO Framework. In conjunction with adopting the 2013 COSO Framework, GAO could develop an implementation guide, which can be derived from the Attributes included in the ED, to demonstrate how the 2013 COSO Framework can be applied to a federal government entity. GAO could also consider whether a separate implementation guide, developed with input from the grants recipient community, would be beneficial to meet the requirements of the OMB Uniform Guidance.

Through the use of the 2013 COSO Framework, federal entities will use an internal control framework that has been widely accepted across industries since 1992. The use of a consistent framework, to the extent possible, will also be beneficial to grant making agencies and other federal agencies that are responsible for monitoring/regulating entities that use the COSO Framework.

Due to the concerns described above, we have not provided responses on the specific questions posed by the ED.

If you have questions about our response, please contact [REDACTED] at [REDACTED] or [REDACTED]

Very truly yours,

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