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### Accounting

#### New COSO Discussion Paper Seeks Comment On Guidance for Monitoring Internal Controls

An influential private sector group of financial reporting experts Sept. 17 released a discussion paper aimed at providing guidance to companies on monitoring systems of internal control over financial reporting, as well as other internal controls.

The Committee of Sponsoring Organizations of the Treadway Commission, known as COSO, launched a two-phased monitoring project designed to make the monitoring component of its 1992 "Internal Control-Integrated Framework" more user-friendly.

As part of the first phase, COSO released the discussion paper to "reinforce and clarify, not add to," previous guidance. During the comment period, open until Oct. 31, COSO hopes to discover if the public finds the paper's concepts "clearly articulated," gauge the extent of agreement with the document's conclusions, and receive examples of innovative approaches to monitoring the effectiveness of internal control.

COSO Chairman Larry Rittenberg told BNA Sept. 17 that the project has been on the committee's agenda for some time. The major motivation behind the project is COSO's belief that public companies have "underutilized" the monitoring component in its 1992 framework, especially with regard to Section 404 of the Sarbanes-Oxley Act of 2002, Rittenberg said.

According to the discussion paper, the 1992 framework consisted of five components. Four components concerned the design and operation of internal control systems, and the fifth component discussed monitoring to "ensure that internal control continues to operate effectively." The discussion document builds on the guidance in the monitoring component.

Rittenberg emphasized that this supplemental guidance remains in a discussion phase and includes broad principles. The second phase will include "practical" examples and case studies. COSO expects to publish the final guidance--the output of both phases--in early 2008. "Companies that want more guidance will get it next year," Rittenberg said.

Grant Thornton LLP worked with COSO on the discussion document. Other participants included an oversight task force consisting of representatives from COSO's five sponsoring organizations, the U.S. Government Accountability Office, audit firms, and both large and small companies. Observers from both the Securities and Exchange Commission and the Public Company Accounting Oversight Board were also on hand. "We were diligent in being inclusive of a variety of entities," Rittenberg said.

#### 'You Get What You Inspect.'

In the discussion paper, COSO sums up the primary purposes of monitoring by the adage, "You get what you inspect, not what you expect." Monitoring promotes good control operation because personnel responsible for the controls being monitored know that proper control operation is verified.


Additionally, monitoring provides an organization's managers and board with "persuasive information" to conclude that the internal control system is working as intended over time, the discussion paper said.

The paper detailed the type of information that is suitable and sufficient enough to be "persuasive." It also distinguished between direct information, which substantiates the operation of controls, and indirect information, such as operating statistics and key risk indicators. A monitoring program must take into account indirect information as well, because it may identify anomalies that might indicate that a control, or set of controls, failed to operate effectively.


According to the discussion document, monitoring is largely a preventative measure. Effective monitoring leads to identification and correction of control weaknesses before they materially affect the achievement of a company's objectives. Although it does not guarantee an error-free internal control environment, under the COSO scheme the focus is on the continued effective operation of internal controls.

Two principles underlie the monitoring component of the 1992 framework:

- ongoing monitoring and/or separate evaluations enable management to determine whether the components of internal control continue to function over time; and
- internal control weaknesses should be identified and communicated in a timely manner to those parties responsible for taking corrective action, and to management and the board as appropriate.

COSO reiterated these principles in its 2006 internal control guidance over financial reporting for smaller companies (134 DTR G-4, 7/13/06 ). The discussion document clarified that these principles are applicable not only to smaller companies. Rather, they are applicable regardless of whether a company is large or small, public or private, for-profit or not-for-profit, or governmental.

COSO recommended its monitoring framework not only for Section 404 compliance, but for other internal control objectives as well. However, both a company's size and the complexity of its business may influence the type, timing, and extent of monitoring.

*The COSO discussion paper is on the group's Web site at [http://www.coso.org/Publications/COSO\\_Monitoring\\_discussiondoc.pdf](http://www.coso.org/Publications/COSO_Monitoring_discussiondoc.pdf) or <http://www.theiia.org/recent%2Diia%2Dnews/>.* 

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