

Accounting Groups Issue Report on Internal Control

Aim is to help companies review and strengthen their controls.

A three-year study to define internal control and provide practical guidance companies can use to assess and improve their control systems has been issued by the five organizations that sponsored the National Commission on Fraudulent Financial Reporting (Treadway Commission).

The report, *Internal Control—Integrated Framework*, can help management assess a company's internal controls and enable all parties—management, board members, auditors, legislators, and regulators—to have a common understanding of internal controls as well as to integrate those controls into business operations.

Undertaken in response to the recommendations made by the Treadway Commission in 1987, the report also spells out the responsibilities everyone in an organization has for proper functioning of controls and describes the external auditor's role in assessing controls.

The report was issued by the Committee of Sponsoring Organizations (COSO), a private sector group consisting of the American Accounting Association, the American Institute of CPAs, the Institute of Internal Auditors, the Institute of Management Accountants, and the Financial Executives Institute. Coopers & Lybrand conducted the study and prepared the report.

"It is our intention that this report establish an understanding of internal control and enable companies to review or strengthen their controls against a common backdrop," said COSO Chairman Robert L. May.

"It will also help companies that issue reports on internal control do so against the COSO standard, which should vastly improve communications to stakeholders," May said. "Finally, legislators and

regulators can look to the report to get a thorough understanding of what internal control actually is and what it can and cannot do."

The report goes well beyond financial controls to incorporate all of the controls management uses in running the company. It also identifies five interrelated components of internal control:

- Control environment, providing discipline and structure;
- Risk assessment, which identifies and analyzes relevant risks to achieving a company's objectives;
- Control activities, the policies and procedures in an organization to ensure management directives are carried out;
- Information and communication of pertinent information that makes it possible to manage and control a business;
- Monitoring to assess the quality of the internal control system's performance over time.

The report is in four volumes, including an "Executive Summary;" a "Framework," which defines internal control, describes its components and provides assessment criteria; "Reporting to External Parties," a supplement of guidance on reporting; and "Evaluation Tools," providing materials useful in evaluation.

The study took three years and involved tens of thousands of hours of research, discussion, analysis, and due process and involved hundreds of people including members of the five COSO organizations, chief executives and board members, legislators and regulators, lawyers, consultants, auditors and academics. Comments from an Exposure Draft issued 18 months ago were considered in preparing the final report.

Members of the Committee of Sponsoring Organizations of the Treadway Commission (COSO) were: American Institute of Certified Public Accountants, Robert L. May, chairman; American Accounting Association, Alvin A. Arens; the Institute of Internal Auditors, William G. Bishop, III; Institute of Management Accountants, Thomas O'Toole; and Financial Executives Institute, P. Norman Roy.

On the project advisory council to COSO were: Gaylen N. Larson, chairman, group vice president, chief accounting officer, Household International; Andrew D. Bailey, professor, department of accounting, college of business and public administration, the University of Arizona; Roger N. Carolus, senior vice president, NationsBank (retired); C. Perry Colwell, senior vice president-financial management, AT&T (retired); William J. Ihlanfeldt, assistant controller, Shell Oil Company; David L. Landsittel, managing director-auditing, Arthur Andersen & Co.; John H. Stewart, assistant treasurer, IBM Corporation; and Howard L. Siers, consultant, general auditor, E.I. Du Pont de Nemours and Company, Inc. (retired).

Principal contributors from Coopers & Lybrand were: Vincent M. O'Reilly, deputy chairman, accounting and auditing; Frank J. Tanki, director, accounting and SEC technical services; R. Malcom Schwartz, principal, New York office; Robert J. Spear, partner, Boston office; and Richard M. Steinberg, partner, national office.

Copies of the complete four-volume report, *Internal Control—Integrated Framework*, are available for \$50.00, and the Executive Summary for \$3.00, by calling 1-800-334-6961; in New York State 1-800-248-0445. (See ad on facing page if you would like to order a copy through the mail.) ■