

Re: PCAOB rulemaking docket matter no. 008 – proposed auditing standard

The PCAOB should try to meet the worldwide expectations surrounding the SOA Corporate Governance reform and contribute to the closing of an extremely dangerous credibility gap, as it is in the position to do if an innovative and effective standard is eventually issued.

- The proposed standard is very disappointing. It retains much of what was submitted by the “*big four*” and expresses an old fashioned, “pre-CoSO”, self-serving, accountant’s way of looking at control.
- Moreover, there seems to be a regression –in the position expressed by the external auditors- to an old fashioned way of looking at control; the “*audit paradigm shift*” and “*continuous assurance*” concepts (1), which were presented in 1998 to the world in the Aicpa’s study on Assurance, seem to be completely forgotten now. For an audit firm who knows well its client, the logic of *continuous assurance* implies that no additional work of any significance should be required in order to attest to the effectiveness of internal control
- Radical changes are needed because an unreasonable burden is about to be charged over all companies listed in the US, when compared with other countries, where advanced corporate governance arrangements are in place, such as Canada and the UK.
- There is very little understanding of CoSO in the proposed standard and little more than a formal homage is paid to it. The reference to CoSO would allow for a much more intelligent, useful, manageable, less costly and burdensome exercise: a higher level overview, which would focus on the right issues and controls.
- The Coso framework (and suggested approach to assessing and reporting on internal control) should be the reference also because it has been extremely successful:
  - It is reflected in the most authoritative, subsequent frameworks (Rutteman-Turnbull in the UK, Coco in Canada, Basel committee in 1998, and it is, finally, incorporated, in its integrity, in the new ERM-Coso, which was released in draft and it is expected to be finalised in February 2004)
  - It has been translated in several languages (French, Italian, Spanish and Portuguese, to my knowledge) and adopted, as an authoritative reference or even as a standard, in several countries
  - It has been used, since years, by best practice internal audit functions to assess and report on internal control (not only in the US).
- The PCAOB should go way beyond the very narrow horizon, which is mirrored, in the current proposed standard. To this purpose it should:
  - Account for the international dimension of the issue and seek ideas and advice in other countries, such as the UK, where a wider internal control assessment and reporting (covering not only financial reporting but compliance and operational effectiveness as well) is carried-out, since 1998, as prescribed by the Combined Code of LSE and specified by the Turnbull operational guidance. A similar high level guidance should be provided by your standard, in my opinion.
  - Consider carefully, and look for, other (than accountants) parties’ points of view on the issue of assessing and reporting on internal control; first and foremost, the PCAOB should listen, very carefully, to what the affected organizations have to say and try perceive how all this is being received from them. One of the strongest points of CoSO is that it represents a shared vision of internal control, which was developed with the participation of CEO’s and management and is aimed at the integration of internal control within operations.
  - Read carefully the “Executive Summary”, at least, of the actual CoSO framework document (not only documents, derived therefrom, which express the accountants’ interpretation thereof).
  - Consider asking the advice of consultants who have gained a worldwide reputation as “internal control experts”, because of their recognized ability to carry-out internal control assessments and to report on them. External auditors have very limited experience on this complex subject.
  - Consult with internal control assessors (2) who do believe that CoSO and other similar frameworks are, in reality, appropriate tools for assessing the effectiveness of the internal control process. Those people have actually used these frameworks and gained experience and knowledge thereof, in the process. They have done so not to comply with any rule but solely in order to assess (as advised to do by the Treadway commission, back in 1987, and by the CoSO report) the internal control of their organizations, to learn whether this process would provide (or deny, when ineffective) the reasonable assurance of achieving the reporting, compliance and operational objectives of their organization.

- The “entity level internal control framework”, represents the very heart of the Internal Control assessment, in accordance with Coso vision. It is the most difficult to assess and where the most significant, dangerous, pervasive and difficult to mend, weaknesses can be found.
- The real risks and the significant control weaknesses emerge when the entity-wide assessment is carried-out. Almost any control weakness at the process/activity level could, in fact, be identified and remedied, when you have a strong internal control framework in place, whereas the strongest activity/process level control would be, easily, voided (circumvented, overridden, by-passed, ridiculed even) within a weak internal control framework. This is fully confirmed by Enron and Worldcom.
- The current focus, within the organizations, is on the documentation of low-level controls for financial reporting. This is absolutely unwarranted on the basis of such consolidated *new* way of looking at internal control; it has nothing to do with the prevention of significant fraud; it has always been considered with sufficient attention within the traditional auditors’ approach to assessing audit risk and there are no additional words which could be spent to deal usefully with this subject. There is no reason to put any additional emphasis on this subject, especially since it is subtracting attention to the really critical subjects which are —as per CoSO- the control environment.
- There is an almost “grotesque”, disproportion in the proposed standard. A lot of attention and detailed guidance is devoted to the easy and less critical assessment of the activity/process risk-control status. In the meanwhile, the assessors is almost left alone to come up with some sort of assessment -and with the task of putting together the related evidence- when extremely difficult and sensitive issues are raised.
- This seems to reflect distrust in the ability to gather persuasive evidence when dealing with entity level control. The use of an anonymous survey of personnel (3) has become a recognised, effective and rather common way of gathering adequate evidence when dealing with the soft, decisive component of control. This technique is well known to the external auditors who regularly use it when assessing the stakeholders’ relationship and dialogue within corporate social responsibility’s assignments. To prescribe (or, at least, encourage) using this effective, widely tested and relied upon technique would represent a significant innovation and an improvement of the auditors’ ability to assess the soft component of internal control.

#### *An Internal Auditor*

#### Suggested readings:

- (1) see, as an example Bell, Mars .. Auditing organizations through a strategic lens – kpmg 1997
- (2) Roth: Control model implementation: best practices - IIARF 1997
- (3) See, as an example, El Paso company internal control questionnaire:  
<http://www.theiia.org/ia/abouttheia/research/Woller-ControlAssessmentSurvey.pdf>