



Business Roundtable

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BY EMAIL

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Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

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Re: *PCAOB Rulemaking Docket Matter No. 008 (Proposed Auditing Standard – An Audit Of Internal Control Over Financial Reporting Performed In Conjunction With An Audit Of Financial Statements)*

Ladies and Gentlemen:

The following comments are submitted on behalf of the Business Roundtable, an association of chief executive officers of leading corporations with a combined workforce of more than 10 million employees in the United States and \$3.7 trillion in annual revenues. The Business Roundtable strongly supported enactment of the Sarbanes-Oxley Act of 2002 (the “S-O Act”), and we support the efforts of the Public Company Accounting Oversight Board (the “Board”) to implement the S-O Act. We appreciate the opportunity to provide you with our views on the Board’s recent proposed auditing standard, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements* (the “Proposed Standard”).

Scope of the Proposed Standard

Under Section 404 of the S-O Act (“Section 404”), management is required to prepare an internal control report that, among other things, is to include an assessment of the effectiveness of the internal control over financial reporting for the issuer. Section 404 separately requires a registered public accounting firm to “attest to, and report on, the assessment made by management of the issuer.” Although the statute envisions a discrete responsibility for the auditor under Section 404 – attesting to, and reporting on, management’s internal control assessment – the Proposed Standard appears to expand the scope of the auditor’s responsibility beyond that contemplated under Section 404. By proposing at the outset that the auditor’s attestation required under Section 404 be characterized as “an integrated audit of the financial statements and internal control over financial reporting,” we believe that the Proposed Standard proceeds from an incorrect premise.

To fulfill Congress's mandate under Section 404, an auditor clearly needs to perform sufficient attest procedures to reach a conclusion regarding management's own assessment and evaluation of the issuer's internal control over financial reporting. These attest procedures need to be robust and aligned with the scope of the auditor's responsibility under Section 404. However, by proposing that the auditor conduct an audit of the internal control over financial reporting, the Proposed Standard embraces a level of testing that is more extensive than that contemplated under the statute. If Congress had intended the auditor to conduct a full-blown audit of an issuer's internal control over financial reporting, it would have expressed such intent by using the term "audit" rather than "attest," and it would have made clear that the scope of such "audit" extended to the entirety of the issuer's internal control over financial reporting and not just management's assessment of this function. Accordingly, we urge the Board to revisit the scope of the Proposed Standard.

In addition to our concerns around the scope of the standard, we believe that the standard as currently drafted, does not permit an auditor enough latitude to exercise its judgment with respect to what is an appropriate level of testing for the specific company. In companies that have strong control environments, routine transactional processing should only require a minimal amount of detailed testing of the controls. Further, the amount of detailed testing should vary by not only the type of transaction stream, but also by the auditor's judgment as to the risk of a material weakness or significant deficiency based on the control environment, including external factors. For example, the payroll cycle would have regular checks by employees and tax regulators, and therefore, an auditor might deem most of the risk to come from unauthorized people being paid and focus detailed testing on that area. In addition, we believe that auditors should be permitted to vary the level of testing from year to year based upon whether there have been changes in the documented controls.

Finally, we believe that a standard that more appropriately focuses on the significant issues around business risk, fraud prevention and detection would better serve the needs of investors rather than the very prescriptive detailed testing approach in the Proposed Standard.

Using the Work of Management and Others

The Proposed Standard sets forth several principles that limit the ability of the auditor to rely on the work of management and others in conducting the required attestation. Specifically, the Board proposes to prohibit reliance on the work of management and others when the internal controls at issue relate to the prevention or detection of fraud that is reasonably likely to have a material effect on the issuer's financial statements and to restrict reliance where the internal controls relate to non-routine transactions. Reliance is essentially only unfettered where the controls relate to routine processing. In addition, the proposal requires that the auditor's own work, on an overall basis, form the basis for the required attestation.

These proposed restrictions may have been suitable if the proposal were being adopted as a stand-alone effort to enhance internal control over financial reporting, but it is not. The S-O Act and the rules adopted by the U.S. Securities and Exchange Commission (the "SEC") to implement Section 404 already bolster the internal control over financial reporting function. Under Section 404, management is required to design and evaluate the effectiveness of the internal control over financial reporting, to prepare an annual report evaluating this function, and to certify as to the effectiveness of these internal controls. Our members and their financial and accounting teams take these new obligations very seriously. The proposed restrictions on the auditor's ability to rely on the work of management and others give insufficient credit to the significant steps that issuers are taking to comply with the Section 404 requirements.

Rather, the Proposed Standard would require auditors to develop and obtain separate and extensive evidence about whether the internal controls are effective. Consistent with the statutory requirement that the auditor attest to management's evaluation of these controls, the auditor should be able to exercise its judgment in deciding whether to rely on management's or others work with respect to the entire range of internal controls, not simply controls for routine processes. This approach will eliminate duplicative, unnecessary testing that would increase issuers' costs significantly with only questionable benefit, if any, for investors.

The final standard also should reflect attestation procedures that allow auditors to place greater reliance on testing performed by internal auditors. The internal audit function is set up to serve as a separate check on the financial reporting process in addition to the work performed by the external auditor. Yet, the Proposed Standard subjects the work performed by internal audit to the same proposed guidelines for reliance to which others within an issuer organization would be subjected. The final standard should allow an auditor to place greater reliance on work performed by internal audit where the outside auditor views the internal auditor to be sufficiently independent and competent.

Accordingly, the final standard should allow the auditor greater flexibility in determining whether to place reliance on the work performed by management and others within the issuer, including, in particular, the internal audit function.

Evaluation of the Effectiveness of the Audit Committee

The Proposed Standard provides that the auditor should evaluate the effectiveness of the audit committee's oversight of the company's external financial reporting and internal control over financial reporting as part of its attestation requirements. The Board proposes that this evaluation should include, among other things, review of the audit committee's independence from management, compliance with applicable listing

standards, and the level of involvement and interaction with the auditor (including the committee's role in appointing, retaining and compensating the independent auditor).

We believe that this proposed requirement is particularly inappropriate given the audit committee's direct responsibility for the appointment, compensation, retention and oversight of the registered public accounting firm under Section 301 of the S-O Act and implementing SEC and securities markets rules and listing standards. By creating a dual evaluation standard for the auditor and audit committee, the proposal would establish a clear conflict of interest. Moreover, the audit committee has responsibilities that go well beyond those in which it interacts with the external auditor, and the auditor does not have any particular expertise with respect to such issues as the independence of individual audit committee members from management. Accordingly, we believe that this aspect of the proposal is ill-conceived, and we urge the Board to eliminate it.

Definitional Issues

We have additional concerns about certain of the definitional aspects of the Proposed Standard. First, the Board proposes a "more than remote likelihood" standard to evaluate whether a deficiency rises to the level of a "significant deficiency" and whether a significant deficiency rises to the level of a "material weakness." This proposed standard creates an unreasonably low threshold for placing a purported deficiency into the "significant deficiency" category and for placing a purported "significant deficiency" into the "material weakness" category. We believe the current standard for determining whether the control component reduces to "a relatively low level" the risk of misstatement is more appropriate for each of these definitions, and we urge the Board to adopt this standard.

Second, the definition of "significant deficiency" also includes the concept that the deficiency at issue must be one that results in an inability to prevent or detect fraud that results in a misstatement that is more than "inconsequential in amount." It is unclear what this phrase is intended to mean; more than "inconsequential in amount" could mean relatively de minimis amounts to any given issuer. This construction could lead to the reporting of deficiencies that are by no means material, simply because they represent a perceived, consequential dollar amount. We therefore also urge the Board to replace this vague construction with a "materiality" concept, which has a more familiar and developed meaning under the securities laws.

* * *

We appreciate your consideration of these comments, and we would be happy to discuss these matters further or to meet with you if it would be helpful.

Sincerely,

A handwritten signature in black ink, appearing to read "David L. Shedlarz", with a long horizontal flourish extending to the right.

David L. Shedlarz
Executive Vice President & CFO
Pfizer Inc.
Chairman-Principle Financial Officers Subcommittee
Corporate Governance Coordinating Committee
Business Roundtable

cc: William J. McDonough, Chairman
Kayla J. Gillan, Member
Daniel L. Goelzer, Member
William Gradison, Member
Charles D. Niemeier, Member