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November 13, 2003

Office of the Secretary
PCAOB
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Dear Sirs:

RE: PCAOB Rulemaking Docket Matter # 008

I offer these comments on selected questions raised in your exposure draft:

Overview:
The Standard obviously addresses the role of the external accountant. The external accountants seem to have significant breadth of scope when this standard is implemented. Considering this is ONLY for financial reporting, the breadth seems too broad. Accordingly, the third party and internal audit work product is relegated to review routine transactions only. This does not make sense. The external auditor does not have the resources to accomplish all that is required; and the corporate world cannot afford to pay for this breadth of scope. This is the equivalent of another full audit – every year?
The external accounting firms are the same firms that are not to do internal control work per prior SEC and NYSE requirements.

Detailed responses to questions:
Question #4: Does the Board's proposed standard give appropriate consideration to **how** internal control is implemented in, and **how** the audit of internal control over financial reporting should be conducted at, small and medium-sized issuers?

Answer: NO; however, maybe you do not need to give further direction.

Question #10: Is it appropriate to require that the walkthrough be performed by the auditor his/herself rather than allowing the auditor to use walkthrough procedures performed by management, internal auditors, or others?

Answer: YES and NO, the external public accountant should be able to use the work of others to perform his/her walkthrough. By using other's documentation (and presuming it is accurate), "walking through" the process(es) will take less time, effort and money than having the external accountant perform this exercise "from scratch." The documentation effort is time-consuming. Is this to be done every year? Can this be phased-in and then continually performed over three years?

Question #12: To what extent should the auditor be permitted or required to use the work of management and others?

Answer: It all depends on the quality of the personnel performing the work (and the same can be said for any team – internal or external to the organization). The quality of the other individuals performing the work could be more qualified and/or far superior than the quality of work performed by a CPA. As an example, a competent internal audit staff will probably have more internal control knowledge of the Information Technology infrastructure, and far more knowledge of the Control Environment than any external resource. There has to be a way of effectively and efficiently using that information. It would make more sense for the documentation to be made available for the external accountant to verify and then test, or spot-check.

Question #13: Are the 3 categories of controls and the extent to which the auditor may rely on the work of others appropriately defined?

Answer: No, they are far too limiting. Whose assertion is it? What is the extent of audit work necessary to opine on management's assertion? This is far too expensive and wasteful. Is this in accordance with the spirit and intent of the law? See my comments to Q#12 as to two examples of areas that can be documented and tested by competent internal resources and reviewed and test-checked by the external accounting firm. The more non-routine the process, the more work the external accountant will have to perform him/herself.

Question #14: Does the proposed standard give appropriate recognition to the work of internal auditors?
Answer: No.

If not, does the proposed standard place too much emphasis and preference on the work of internal auditors or not enough?

Answer: Not enough. Please understand, a significant quantity of internal auditors were previously external accountants. Many have certifications including CPA and CIA, among other certifications. Most internal auditors have more years of business experience than the senior accountants that will perform the majority of the certified external accounting work

By not allowing external accountants to rely on internal audit documentation (at a minimum) and testing, your proposed Auditing Standard diminish the worth and value of internal audit work in those corporations - where they do add significant value.

From my experience, internal auditors can know more about the risks, the Information Technology Infrastructure, Enterprise Risk Management, Risk Management, the Control Environment as well as the Information and Communication and Monitoring aspects of Internal Control than the public accountants could ever afford to know over three years (average length of time it will take for the external accountants to fully document and understand the nuances of significant processes) of auditing a major corporate client. Internal audit can develop and maintain a working knowledge and rapport which can be more effective than a team of accountants that are doing a walk-through over two or three weeks. How can external accountants do the non-routine processes, fraud reviews, and information technology infrastructure in an abbreviated time frame?

Question # 17: Will the definitions in the proposed standard of **significant deficiency** and **material weakness** provide for increased consistency in the evaluation of deficiencies?

Answer: I cannot image how. If a **significant deficiency…** "results in more than a remote likelihood that a misstatement of the … financial statements that is more than inconsequential in amount …" Remote means… slight.
If a **material weakness** is a significant deficiency that … results in more than a remote likelihood that a material misstatement … will not be prevented or detected."
So, in this wording, are we dealing with 6 sigma for "remote?" Is "more than a remote likelihood," "6 sigma plus one?" FASB Statement #5 Paragraph 3 is, in my opinion, poorly worded and far from definitive and thus should not be used. Where are "slight" and "likely" defined?

How can the definitions be improved?
By giving straightforward, meaningful, definitive definitions that can be finitely correlated to probability or some words of substance.

Question #18: Do the examples in Appendix D of how to apply these definitions in various scenarios provide helpful guidance?

Answer: Yes, to some degree.

Are there other specific examples that commenters could suggest that would provide further interpretive help?

Answer: Yes.

Examples:
1 – Of Pervasiveness: Correlate to the depth, breadth and organizational (executive or local) level within the corporation:

2 – When would an aggregation of significant deficiencies NOT constitute a material weakness?
3 – Examples describing a) Organizational segregation of duties issues; b) Incompetence; c) A strong overbearing personality of CEO/President to circumvent internal controls (by intimidation); d) The impact of compensating controls (insurance et al) on control deficiencies.
4 – What is the value of a SAS 70 review (performed by a PCOAB-registered external accounting firm) as it relates to the internal controls at an outside service provider?

> **Outside Service Audits:**
> An additional meaningless exercise has been SAS 70 reviews. What do they indicate? What value do they add? As you address outside service agreements, perhaps you can add some teeth to SAS 70 reviews. SAS 70 "comfort letters" are the current "standard" that applies to outside service audits.
> Are you aware of any organization who ever "failed" a SAS 70 review? SAS 70 reviews, as currently performed have minimal to no value for SOX 404 reviews.

Question # 29: Are there any specific internal control-related non-audit services the auditor should be prohibited from providing to an audit client?

Sure, did not the SROs say they couldn't perform these audits? Isn't this what caused/ started the demise of the CPA profession (e.g. Arthur Andersen)?

Most CPAs are NOT trained to review for fraud, and they typically do not find it. In two of the more publicized bankruptcies, the internal auditors found the improper accounting treatment and raised the issue. So why are you considering leaving the evaluation of the controls over the prevention of fraud to only the public accountants? The CPA profession has been trying (for decades) to disclaim responsibility for the review of fraud.

Questions # 30 & 31:
Commentary: Your questions add additional confusion as the purpose and intent of SOX Sections 302 and 404. Are they to be different?

When the "interpretation" came out stating that 404 was only for the reliability of financial statements as of a point in time; and did not include the COSO segment referring to adherence to laws and regulations, I did not understand this interpretation.

Let us go back to the implied purpose and intent of SARBOX and then answer these questions. According to the prior "guidelines," (SEC official statements) - if a material control weakness was corrected in Q2, Q3 or Q4 and was in place and operating "as of year-end," my interpretation of your prior statements is: Yes, the material control weakness was corrected as of year-end (a point in time). Is the process in effect and operating during a significant period covered by the financial statements – no or probably not!

If you violate the law (COSO Laws and Regulations) – Can it have a significant impact on the financial statements? – Sure. – Is it an internal control weakness? – Sure.
How can this segment of COSO be excluded?

This Standard is an excellent tutorial and overview of internal control documentation, and of what was taught previously by the Big-8. It is too bad the public accountants stopped auditing in this fashion. **We need to get back to the basics.** The SOX 404 work appears to reintroduce the concept of "permanent files" updated annually during the current year "preliminary work." Congratulations, a very good Audit Standard for audit documentation!

Respectfully,

David Kowalczyk