
From: Malcolm Schwartz [malcolm@crsassociatesllc.com]
Sent: Tuesday, November 25, 2003 9:27 AM
To: Comments
Subject: PCAOB Rulemaking Docket Matter No. 008

Dear PCAOB:

I apologize for these comments being after the 5:00 PM (EST) November 21, 2003, cutoff. So, if you wish to ignore them, you are certainly entitled to do so.

But, as a one of the listed principal authors of The COSO Report, which you cite and which framework you follow to a great extent, and as a consultant practitioner who has applied and refined The COSO Framework over the past twelve years while working with clients who wished voluntarily to apply the Framework, either to prevent, or respond to, problems with internal control, I just wanted to voice some concerns with the proposed auditing standard.

My concerns derive from my seeing the ways that some firms, including some major audit firms, are incorrectly advising their clients in regard to Sarbanes - Oxley compliance; and my fear that the proposed standard might fail to correct some of this incorrect advice.

One major problem is that some firms have confused the COSO illustrative tools with the COSO Framework, and hence have failed to focus sufficiently on all five components of the Framework, and the major control breakdowns regarding such exposures as fraud, collusion, management override and intentionally misleading information. Your proposed standard clearly identifies the five components of control that comprise the COSO Framework, but your proposed standard then goes into substantial detail on transaction controls, with less attention and balance to fraud, collusion, management override and intentionally misleading. Furthermore, I have seen clients negatively impacted by situations that would pass the examples of controls testing (for example, in the case of vouchering, as well as in the case of shipping documentation) that you provide in your proposed standard.

Another problem is related to the preceding observation. It is that some firms providing advice are treating fraud as a separate process, for example, and not as a condition that results from being able to overcome weak controls in basic business processes. Too many of the tools being applied go into great detail regarding transaction-related controls, and on the other hand treat fraud through a review of simple checklists. I have found that this approach can be improved, and integrated, through treating all five controls components and their associated internal controls as effected through both management and business processes.

As a management consulting partner at PricewaterhouseCoopers (and Coopers & Lybrand before that) prior to my retirement, I spent some time, after the COSO Report was issued, in developing tools for both my consulting teams and the auditors to use in regard to controls assessments, and also trained audit staff in regard to analyzing processes. I generally found that auditors were more comfortable with checklists than with process analysis, and this bias might inhibit their abilities to apply the kind of walkthroughs and tests that are described in your proposed standard. It will be important, therefore, for auditors to be well-trained in these new approaches, to have the need for judgment be limited as audit firms gain leverage through the use of younger and less-experienced staff, and to give attention to auditing the auditors.

I understand why you have combined in one standard the testing of financial statements and the testing of internal controls over financial reporting, but I fear that this will lead to overly focusing on detailed transaction controls, related to substantive testing and to traditional checklists, as opposed to testing related to the major exposures that are the primary concern of Sarbanes - Oxley. This overly detailed orientation is what I am finding in the work of some firms providing advice to clients regarding the documentation and testing required for Sarbanes - Oxley compliance. I simply suggest that your standard reinforce, if it can, the distinctions between the testing of financial statements, and the testing of business and management processes related to all five components -- the integrated framework -- of the COSO Framework, for internal controls over financial reporting.

If you do read this even though it is past the cutoff, and if it is of any interest to you to pursue any of these concerns, I will be happy to share with you some of the relevant tools and approaches that I have developed over the years since I helped to create The COSO Report. I have built this experience into the approach that I am helping to develop for supporting clients in regard to Sarbanes - Oxley compliance for Technology Solutions Company, a systems integrator

consulting company, and I am getting good reaction to our approach from knowledgeable industry parties.

Malcolm Schwartz
Senior Vice President, Technology Solutions Company
And
COO, CRS Associates LLC

14 Edgewood Drive
Summit NJ 07901
office:908-273-6967
fax: 908-273-1586
mobile: 908-803-8918
email: malcolm@crsassociatesllc.com
web: <http://www.crsassociatesllc.com>

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Summit NJ 07901
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fax: 908-273-1586
mobile: 908-803-8918
email: malcolm@crsassociatesllc.com
web: <http://www.crsassociatesllc.com>