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To: Comments
Subject: PCAOB rulemaking docket matter No. 009

Office of the Secretary:

On October 7, 2003, you voted to seek comment on Rule 3101, describing the use of certain key terms used to impose obligations on the internal control (for financial reporting) practitioner. I am a registered professional engineer (PE), associated with various SarBox response initiatives, burdened by an unconditional obligation to warn preemptively when an engagement project is certain to fail. The conditions of license, through our code of ethics, hold public safety, health and welfare paramount.

As our society ascends in complexity, lifted by a surge of engineered artifacts, it becomes increasingly difficult to design a set of permanent rules that avoids significant unintended consequences to stakeholders. The following commentary originates from the perspective of the rapidly advancing process of engineering and addresses the three categories of "rules" described in your Rule 3101 briefing paper.

The working-level structure of a "rule"

To engineering process, a rule is a task action imperative in the form of an "if, then" statement. Rules impose a direct obligation to perform a specified activity in specified circumstances under specified conditions. A rule forcibly removes the intellectual duty from the practitioner at the work face to be acquainted with mission objectives, stakeholders, or the variety of task action alternatives. Higher authority has ordained the appropriate goal-seeking action.

Like the coach that sends in plays to the huddle, whatever consequences (ends) develop from strict obedience to the rule are the sole responsibility of the rule maker (means). Wherever rules command means, both goals and consequences automatically become immaterial to the executors. Governance by rules, appropriately applied, is the most productive organizational arrangement for repetitive, routine labor, exhibiting a significant property described mathematically in control theory as super stability.

"shall"

Your conventional definition of unconditional obligation imposes a direct duty to perform a specified activity under (presumably) defined circumstances and conditions. The present definition is dangerously incomplete. It should be clearly stated that, with faithful rule execution, the PCAOB takes full legal responsibility for all consequences. You cannot include objectives for the "shall" category. Since professional judgment (intelligence) has been administratively subsumed, only the rule maker can logically be responsible for outcomes. "Shall" is the practitioner latch-in switch to robotic obedience mode. There is an apt saying in the engineering profession exactly equivalent to this rule category - "Whoever picks the parts owns the behavior."

Severe consequences attend any attempt to associate the practitioner with either goals or consequences - for the unconditional obligation category. If the practitioner is held responsible for any role other than blind obedience to execute the task, you will encourage the very consequences you seek to avoid. When you instruct the practitioner to obey a command without employing intelligence (appropriate selection) - and then attach responsibility for any damage that should result, all advantage to this category is immediately destroyed. The practitioner, trapped in cognitive dissonance by the dichotomy, becomes your adversary instead of your ally.

"should"

Your definition of presumptively mandatory is logically consistent. You provide the objectives of the rule in full coherent, structured detail (from prime to generalized to functional to tangible) because the uniquely possible circumstances are too variable, numerous and complex to describe. It is then reasonable to require the professional to provide a scrutably connected rationale for his goal-seeking action choice. Since the professional is accountable for appropriate selection, and vested with commensurate authority to pursue necessary and sufficient competent evidential matter, he is fully and independently responsible for outcomes.

While you correctly require the effort to provide scrutable connectivity for rule deviations, you must also require the same rationally linked audit trail for rule adherence. The chances that the stated "should" rule is an appropriate selection for a particular assignment are no better than the alternatives. When the practitioner is required to objectively justify the stated rule, the chances that a superior alternative will be found for the client approach certainty. When the burden of proof is placed asymmetrically on the alternative, the selection criteria at the work face become skewed to obedience and professionalism, along with the client, suffers another blow.

The logical curse of "rule" is that when you specify both goals and means, you have irrationally locked two vastly separate and dissimilar domains together that can never comprise an appropriate selection in the operational reality. Locking means to ends (perform "this" activity but attain "that" goal) is forbidden by the second law of thermodynamics to be appropriate selection. At the same time the practitioner shows his selected strategy of action to be appropriate, he is obliged to show contemporaneously that your rule choice is less appropriate. This is not an added burden because the procedure is, exactly, how the practitioner selects the alternative in the first place. Meanwhile, of course, the second law is incessantly increasing the entropy of the "shall" category until, sooner or later, it too must collapse.

Further, rules from the institutionalized regulatory process are the product of a protracted damage response record. The science and technology of damage avoidance for an uncertain future, which is another way of saying engineering design process, makes an intellectual demand three orders of magnitude above that required for damage response. Forming rules from damage sustained is a "rule" itself, unrelated to the method technology of prevention. In the last five years, thanks to new levels of computer power, the capability of the process of engineering to avoid damage has rendered the conventional standards process obsolete. When damage avoidance is practical, regulation by damage response makes little sense.

"may"

The definition of subsidiary obligation is logically consistent. Any practitioner will welcome all the applicable checklists he can find. Investigating a variety of considerations is, basically, what practitioners mostly do. You have a duty here limited to describing the originating circumstances of the "may" issues, actions and procedures in abundant detail. The context for intelligent choice (appropriate selection) is more critical to success than the task action menu. While you have no duty to goals or consequences, if you intend for the practitioner to make appropriate choices, your descriptions of relevant circumstances must be lavish. The mere fact this category is deemed essential at all is the historical record of unexpected wrecks and calamities. These hard-won scenarios of lessons-learned should be brightly illuminated.

Overriding constraint

The PCAOB assignment to spawn rules that will remedy the class of Enron cataclysm is much more than challenging. Your mission is impossible. The assumption that internal control over financial reporting can be treated in isolation, to some systemic benefit, has been proven fallacious by the Institute of Internal Auditors (IIA) for over fifty years. Internal control over financial reporting is so densely coupled to company operations and civil law, experience has shown, that regulatory trifurcation will greatly increase, not decrease, the window of opportunity for undetected mischief. The attempt to design a set of rules confined to one third of an integrated system that will "somehow" regulate the system as a whole, is just another uninteresting failure of man to defy universal law. Nobody defies control theory.

The opportunity to provide commentary to the PCAOB in this convenient format is greatly appreciated.

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