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May 5, 2005

Mr. J. Gordon Seymour, Acting Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, DC 20006-2803

Re: PCAOB Rulemaking Docket Matter No. 018, Proposed Auditing Standard on Corrections of Material Weaknesses in Internal Control Over Financial Reporting

Dear Mr. Seymour:

I have read the Proposed Auditing Standard – Reporting on the Elimination of a Material Weakness – and, in general, support the issuance of a standard that allows companies to report to its investors that an attest engagement has confirmed the remediation of a previously reported material weakness. The endorsed auditor communication that a material weakness has been eliminated may add credence to the recently adopted internal controls reporting regime proposed by the PCAOB and approved by the SEC (i.e., Audit Standard 2 (AS2)), provide investors and other interested parties with timely information they need to make prudent decisions, and encourage management to properly address material weaknesses prior to filing a 302 certification stating the resolution. Additionally, making this a voluntary standard should allay the fears of additional regulatory costs and truly moves toward a market-based approach.

I am concerned with the nature of the proposal as it relates to control objectives outlined in paragraphs 11, 12, 13 and 14. The definition provided in this proposal may detract from AS2's objective of a controls-based, integrated audit by producing a myriad of control objectives without increasing the confidence of an "… assessment,…, of the effectiveness of adequate internal control structure…."[1] Furthermore, the increased specificity may produce a public expectation that cannot be supported by the work performed and may ultimately result in a loss in public confidence in the audit process[2]. By not allowing auditors and companies to focus their risk assessment (and by extension control objectives) on the flow of transactions and events, companies and auditors may lose sight of the financial reporting risks associated with business process activities and related information processing systems, and instead focus attention on account balances that are only a reflection of previously processed transactions and events.

It appears that the PCAOB requires auditors, and companies by extension, to identify very specific control objectives that relate to the assertions relevant to account balances instead of the

[1] Sarbanes-Oxley Act of July 2002, Section 404 (a)(2)
[2] The Social Responsibility of the Auditor (1985), (Limperg Inistituut, Inter-University Institute for Accountancy, Amsterdam, The Netherlands, 1985), p. 39

processes that generated the account balances.[3] Furthermore, the proposed definition requires a level of precision that goes beyond that required to maintain an effective internal control structure. For instance, paragraph 13 provides an example that states "The Company has legal title to recorded product X inventory in the company's Dallas, TX warehouse." This example, if taken at face value, implies that companies would be required to detail out multiple permutations of control objectives. If a company had 30 locations that stored product X, would the company be required to identify 30 control objectives to cover the rights and obligations assertion for each inventory location? Add into the mix that the inventory accounts may have multiple assertions and you may have up to 210 control objectives[4]. This simple calculation does not take into consideration the multiple product lines or other financially significant accounts related to inventory; nor does it mention the potentially hundreds or thousands of accounts that could be subject to evaluation.

Paragraph 11 references AS2 paragraphs 68 to 70 as a source for understanding relevant assertions. These paragraphs correctly discuss relevant assertions for each significant account and explain how to evaluate whether an assertion is relevant for a given account. Furthermore, paragraph 12 references AS2 paragraph 88 which instruct the auditor to align controls with control objectives when evaluating the design effectiveness of controls. However, these paragraphs do not directly correlate financial statement assertions to control objectives.

The Committee of Sponsoring Organizations ("COSO") of the Treadway Commission's publication, *Internal Control – Integrated Framework* [5] report states the following:

> The factors representing fair presentation can be viewed as basic financial reporting objectives. These would be supported by sub-objectives represented by the financial statement assertions, which in turn are supported by related objectives identified with respect to an entity's various activities.

The COSO statement above explicitly states that the financial statement assertions (i.e., sub-objectives of fair presentations) are supported by various activity [or process or control] objectives. If a company has as one of its various activities inventory management, companies should be able to identify control objectives that control the process for managing inventory. This appeared explicit in AS2 paragraphs 40, 42. These paragraphs consistently state, among other objectives (e.g., the initiating and processing of non-routine and non-systematic transactions), that companies should identify controls over the initiating, authorizing, recording, processing and reporting of significant transactions.

Also, this control objective definition may conflict with other SEC and PCAOB regulations. For example, SEC and PCAOB regulations require a company to "…base its evaluation of the effectiveness of the company's internal control over financial reporting on a suitable, recognized control framework that is established by a body or group that has followed due-process procedures, including the broad distribution of the framework for public comment." Since COSO appears to be the framework of choice, this may result in companies altering the COSO

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[3] AS 2 mentions the phrase control objective 10 times in paragraphs 8 (twice), 12, 40, 85, 86 (twice), 88, B23, E116.

[4] Although there are only 5 categories of Financial Statement assertions defined by COSO, the number of assertions applicable to an account may be 7 since the assertions of Existence, Occurrence, Valuation and Allocation may exist simultaneously for any given account.

[5] See COSO, Internal Control-Integrated Framework (1992) ("COSO Report"), p. 32

framework's intent that activity-level (or process or control) objectives support financial statement assertions which, in turn, support entity-level financial reporting objectives.

One other point worth mentioning is that the COSO report doesn't define "control objective" in the glossary or in the body of text itself. Also, the illustrative evaluation tools provided by the COSO report do not take the approach outlined in this proposal when identifying control objectives for various activities.

The COSO approach permits companies to outline their activity-level (or process or control) objectives based on a process framework. This approach recognizes that financial statement transactions enter a company's books and records through processes and do not appear by happenstance. Adopting the current definition of control objective may negate years of research and development in how best to obtain control (i.e., know) over processes that lead to financial reporting. For example, Peter F. Drucker states, "The purpose of control is to make the process go smoothly, properly, and according to high standards.[6]" The "high standards" are the financial statement assertions outlined in the Audit Standard 2. "Smoothly" and "properly" are recognized in the activity level objectives combined with the information processing objectives in COSO Chapter 4. Allowing companies and auditors to develop appropriate control objectives using a structured approach as provided in the COSO report will benefit society by allowing companies and auditors to focus on significant process risks.

This definitional change to the phrase "control objective" should be addressed in an addendum to Audit Standard 2 rather than this proposal. Doing so will allow external auditors and companies in general to ascertain the impact to their compliance efforts. I hope the feedback provided is constructive and applaud the standards developed by the PCAOB implementing SOA section 404.

I appreciate the opportunity to provide feedback and generally agree with the direction of auditor confirmation of remediated material weaknesses. If you need any additional information or have questions, please contact me at bwilson@acutrolerp.com.

Sincerely,

Bryan E. Wilson

[6] Peter F. Drucker, Management: Tasks, Responsibilities, Practices (HarperCollins Publishers, Inc. New York, 1973), p. 218