



**Committee of Sponsoring Organizations of the Treadway Commission**

American Accounting Association, American Institute of Certified Public Accountants, Financial Executives International, The Institute of Management Accountants, The Institute of Internal Auditors

**COSO Chairman**

Larry E. Rittenberg, Ph.D., CIA, CPA  
975 University Avenue  
Madison, WI 53706-1323  
Tel +1-608 262-2267  
lrittenberg@bus.wisc.edu

February 22, 2007

Office of the Secretary  
PCAOB  
1666 K Street, NW  
Washington, DC 20006-2803

Re: PCAOB Rulemaking Docket Matter No. 021

On behalf of the COSO Board, I am submitting our comments on the proposed revision to AS 2. COSO is supportive of the PCOAB in its objective to revise AS2. We find the focus on a top-down risk-based approach to be consistent with the COSO internal control framework.

COSO is committed to the proposition that all companies ought to have effective internal controls. The response to our guidance for smaller public companies has been quite positive as companies have found the principles in the guidance to be scalable across different sizes and industries.

COSO is currently working on a project to better define the monitoring component of the COSO *Internal Control - Integrated Framework* (ICIF). It is our sense that many companies have not fully integrated the monitoring component into their overall control structure, and therefore they have not effectively utilized the monitoring component to better manage the costs of meeting the Sarbanes-Oxley Section 404 requirements. Our original publication of the internal control framework (1992) states that:

“Monitoring ensures that internal control continues to operate effectively. This process involves assessment by appropriate personnel of the design and operation of controls on a suitably timely basis, and the taking of necessary actions.” (Chapter 6, p. 1)

The monitoring concept is more fully articulated in the COSO *Internal Control over Financial Reporting – Guidance for Smaller Public Companies*. Internal control is a process that is ongoing, as is illustrated on page 11 of Volume II of the smaller business guidance. Monitoring is an integral part of that process, and can be performed in a number of different manners ranging from computerized continuous monitoring to separate corroborating reviews by internal audit.

The current project on monitoring is being conducted in two phases: the first phase will lead to the publication of a preliminary “white paper” [pre-exposure draft] articulating the concepts of the monitoring component of the COSO ICIF. The second phase – which includes an exposure process - will seek public comment on the white paper concepts along with an identification of approaches that companies are using to implement both on-going and separate evaluations of their internal control structure. COSO believes that this guidance will provide more insight into situations in which management will be able to utilize effective monitoring, along with other assessment methods, where applicable, to support their assertion on the effectiveness of internal control over financial reporting. .

We are planning on the release of the white paper by late March. We will share that document with you as soon as it is ready. We plan on issuing an exposure draft for public comment during the summer and completing the project by January 2008. We have a very broad task force working on the project including representatives from the user community, preparer community, government officials, auditors, and consultants. We are very optimistic about the potential contribution of this project to better develop cost-effective approaches to internal control monitoring.

We have two comments for the PCAOB’s consideration:

1. We encourage the PCAOB to consider our forthcoming white paper on monitoring, as well as our guidance for smaller businesses that was issued last year, as you further develop the new audit standard. Our objective is to have organizations recognize that monitoring can be built-in and that management’s assessment of internal control is not necessarily an addition to, or layered on top of, the entity’s system of internal control over financial reporting. Our whitepaper and forthcoming guidance will further articulate the concept and provide guidance for organizations to help them build effective monitoring into their internal control structure. Although directed at management, the guidance may also be useful for auditors and audit committees.
2. Your proposed guidance suggests one approach to monitoring which you refer to as *Benchmarking*. The term is described in the context of evaluating continued reliance on application controls in an IT environment. COSO believes that the general concepts you describe as benchmarking may be applied across the organization as an example of one approach to effective monitoring, i.e. understanding the control environment, identifying process changes that have a reasonable possibility of materially impacting the financial

statements, ensuring processes are in place to test those changes (including interaction with other processes), and determining if the monitoring is working effectively. We also believe that consistency in terminology would be helpful, i.e. both of the examples refer monitoring.

COSO believes that monitoring is an essential part of an organization's internal control structure. We would be pleased to work with the PCAOB to increase the understanding of monitoring. The COSO Board would be pleased to further discuss the monitoring project or any other aspect of internal control over financial reporting as captured in the *COSO Internal Control Integrated Framework*.

Sincerely,

Larry E. Rittenberg, PhD, CPA, CIA

**COSO BOARD MEMBERS**

Larry E. Rittenberg, Chair

Chuck Landes, AICPA

Mark Beasley, AAA

Edith Orenstein, FEI

David Richards, IIA

Jeff Thomson, IMA