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February 23, 2007

Laura Phillips
Deputy Chief Auditor PCAOB
C/O Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington, D.C. 20006-2803

Re: PCAOB Rulemaking Docket Matter No. 021
Subject: Comments on Draft SEC / PCAOB SOX Proposals

Dear Ms. Phillips:

The American Society for Quality (ASQ) is pleased to submit the attached comments on the PCAOB's proposed auditing standards relating to internal control over financial reporting.

ASQ recognizes the importance of the Sarbanes-Oxley Act (SOX) to the global economy and the role it plays for investors by providing transparency in organizational finances. To this end, in 2004 ASQ instituted a new organization, the Sarbanes-Oxley (SOX) Community. The goal of this community is to provide dialogue in understanding the role quality and environmental management systems can play in supporting organizations' compliance to the Act.

Much of the dialogue has centered on Section 404 of the Act. The requirement that organizations must have and be able to demonstrate an effective system of control led to research of various methods of providing effective quality and environmental management systems. The Community reviewed the Malcolm Baldrige Award criteria, the Six Sigma methodology and the ISO standards ISO 9001:2000 and ISO 14001:2004. The ISO standards were selected as a pair because of their closeness to the structure of the COSO guidance used by most organizations to satisfy Section 404 and because many public companies are registered to ISO 9001 and 14001.

With this background in mind, the Community formed a "SOX Team" to review the recent SEC and PCAOB draft documents published on December 19, 2006. We applaud your efforts to re-focus industry responses to a "risk-based, top down approach." The result will be that organizations will focus on the key controls which can indicate the possibility of material misstatements in financial statements. This will surely reduce the cost of compliance, but will also allow an organization to focus on its important business processes. It will also foster the use of quality improvement tools on these processes and will result in a more effective operation of the organization.

A major part of the SOX Team effort has been to look for ways of "building quality" into the development of financial reports. Our review of your December 19 publications has given us an opportunity to put specificity on this term. The SOX Team has found

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opportunities in the two documents which include the following key practices of the quality and environmental communities:

- Continual improvement techniques
- The use of data analysis to identify and correct potential risks
- Methodology for assuring personnel competence
- Controls to manage an organization's documentation and records
- Clarification of management's roles and responsibilities.

The American Society for Quality would like to applaud your efforts to reduce the impact of Sarbanes-Oxley on industry and your special attention to small businesses. Quality practices have been very important to small organizations because the reduced staff in these organizations make their effective operation crucial. It is also proper that external auditors use the work of others, including procedures and records of internal quality and environmental managers, engineers, and auditors.

I would like to offer the services of the SOX Team to support your future efforts. We recognize the great importance of Sarbanes-Oxley to the well being of our country and are quite willing to help as your committees move forward.

Thank you,



Ronald D. Atkinson
President
American Society for Quality

Attachment: The American Society for Quality Sarbanes-Oxley Team Comments on
"An Audit of Internal Control Over Financial Reporting that is Integrated
with an Audit of Financial Statements"

About the American Society for Quality

The American Society for Quality (www.asq.org) is the world's leading authority on quality. With more than 90,000 individual and organizational members, the not-for-profit professional association advances learning, quality improvement and knowledge exchange to improve business results, and to create better workplaces and communities worldwide. As champion of the quality movement, ASQ offers technologies, concepts, tools and training to quality professionals, quality practitioners and everyday consumers, encouraging all to Make Good Great®. ASQ has been the sole administrator of the prestigious Malcolm Baldrige National Quality Award since 1991. Headquartered in Milwaukee, Wis., the 60-year-old organization is a founding partner of the American Customer Satisfaction Index (ACSI), a prominent quarterly economic indicator, and also produces the Quarterly Quality Report.



To: Public Company Accounting Oversight Board

Re: PCAOB Rulemaking Docket Matter No. 021

Subject: The American Society for Quality Sarbanes-Oxley Team Comments on “An Audit of Internal Control over Financial Reporting That Is Integrated with an Audit of Financial Statements”

1.0 Introduction

The PCAOB is proposing a new auditing standard, *An Audit of Internal Control over Financial Reporting that is Integrated with an Audit of Financial Statements*, that would supersede its Auditing Standard No. 2.

The PCAOB has invited interested parties to comment on the document. The Sarbanes-Oxley (SOX) Team consisting of five members of the American Society for Quality (ASQ) SOX Community¹ was asked to comment on the new audit standard. Over the past two years, the “Team” has conducted 2 ASQ Sarbanes-Oxley (SOX) conferences, a webinar and 6 workshops and presented numerous papers at conferences and in publications such as ASQ’s *Quality Progress* and The Institute of Internal Auditors (IIA)’s the *Internal Auditor*.

The Team has shown that the quality and environmental management systems (QMS/EMS) of public companies can directly support SOX compliance. Many public companies are registered to the QMS standard ISO 9001:2000² and the EMS standard

¹ The five members are Dr. Sandford Liebesman, ASQ Fellow and Chairman-Elect ASQ Electronics and Communications Division, Paul Palmes, Vice-Chairman US Technical Advisory Group to ISO TC 176 (the developer of ISO 9001:2000), John Walz, The Sutton Group, Donna Spencer, The NORDAM Group and Marty Jaeger, Jaeger-Holland.

² ISO 9001:2000 Quality Management System Requirements. As of December 2005, the number of ISO 9001 registrations was 776,608 worldwide, 59,663 in North America and 44,270 in the United States. Registered organizations are audited every six months by an accredited registrar. The United States accreditation agency is the RABQSA.

ISO 14001:2004³. We will show how satisfying these standards provides valuable inputs to the SOX auditing process.

A member of the Team published articles in the September 2005 issue of *Quality Progress*⁴ and the October 2005 issue of the *Internal Auditor*⁵ linking the ISO standards to COSO, the most common system used to comply with the SOX Section 404 requirement to have an effective system of internal control. The Team has pointed out the roles that QME/EMS can play in support of financial management systems compliance efforts.

The proposed auditing standard uses the phrase “work of others” 77 times. Much of this information can be acquired from Operations, and Quality and Environmental Management systems. The comments below describe specific parts of the proposed auditing standard where valuable QMS/EMS support applies. The comments focus on the strengths that quality and environmental management and auditors bring to the table: continual improvement techniques, monitoring and measurement of processes, analysis of data and identification of risks to the organization’s objectives, corrective and preventive action methodology, auditing support, personnel competence methodology, assistance with walkthroughs, controls to manage the organization’s records, and clarification of management’s roles and responsibilities.

2.0 Comments on “An Audit of Internal Control over Financial Reporting (ICFR) That Is Integrated with an Audit of Financial Statements”

Comment # 1: page 2: “First, the audit of internal control over financial reporting has produced significant benefits. Issuers and auditors have described a focus on corporate governance that had not existed in the past and improvements in the quality and efficiency of important corporate processes and controls.”

QMS/EMS Comment:

- **QMS:** ISO 9001, Clause 8.5.1 provides a methodology for continual improvement of a management system.

³ ISO 14001:2004 Environmental Management System Requirements. As of December 2005, the number of ISO 14001 registrations was 56,593 worldwide, 7,119 in North America and 5,061 in the United States. Registered organizations are audited every six months by an accredited registrar. The United States accreditation agency is the RABQSA.

⁴ Sanford Liebesman, “Mitigate SOX Risk with ISO 9001 and 14001,” Standards Outlook, Quality Progress, September 2005, 91-93.

⁵ Sanford Liebesman, “Quality in the Mix,” Risk Watch Column, The Internal Auditor, October 2005, 73-77.

Comment # 2: page 18: Question 14: “Can the auditor perform an effective audit of internal control without performing an evaluation of the quality of management's process?”

QMS/EMS Comment: No. the following QMS/EMS clauses provide valuable inputs:

- **QMS:** ISO 9001, Clause 8.2.3 requires “Monitoring and measurement of [the organization’s] processes” and Clause 8.4 requires analysis of data obtained as a result of Clause 8.2.3. The results of the analysis are used in the identification of risks and in corrective and preventive actions.
- **EMS:** ISO 14001, Clause 4.5.1 requires monitoring and measurement, on a regular basis, of the key characteristics of its operations that can have a significant environmental impact and Clause 4.5.2 requires evaluation of compliance.

Comment # 3: page 21: “When the auditor duplicates high-quality, relevant work that already has been performed by competent and objective individuals; he or she risks increasing effort without enhancing quality.”

QMS/EMS Comment: The SOX audit effort can be reduced by using the “work of others” from the results of QMS/EMS audits:

- **QMS:** ISO 9001, Clause 8.2.2, “Internal Audit,” provides a methodology for conducting internal quality audits.
- **EMS:** ISO 14001, Clause 4.5.5, “Internal Audit,” provides a methodology for conducting internal environmental audits.
- **QMS/EMS:** In some instances, an audit of ICFR duplicates inquiries made during ISO 9001 and ISO 14001 audits.

Comment # 4: page 25: Question 20: “Does the proposed definition of relevant activities adequately capture the correct scope of activities, including activities that are part of the monitoring component of internal control frameworks? **page 23** “Definition of relevant activities: Relevant activities are defined as those that provide evidence about design and operating effectiveness of internal control over financial reporting or that provide evidence about potential misstatements of the company's financial statements.”

QMS/EMS Comment: Yes, if QMS/EMS activities are included in relevant activities.

Comment # 5: page 25: Question 23. “Does the proposed standard provide an appropriate framework for evaluating the competence and objectivity of the persons performing the testing? Will this framework be sufficient to protect against inappropriate use of the work of others? Will it be too restrictive?”

page 25: Question 24. “Has the Board identified the right factors for assessing competence and objectivity? Are there other factors the auditor should consider?”

page 24. “Factors related to competence include such things as the education and experience level of the individual performing the testing, as well as the quality of his or her work”.

QMS/EMS Comment: The framework is very general as it should be. The framework should include evaluation of the effectiveness of training provided by the organization.

- **QMS:** ISO 9001, Clause 6.2.2, “Competence, Awareness and Training,” and **EMS,** “ISO 14001: 2004, Clause 4.4.2, “Competence, Training and Awareness,” require determination of competence, provision of training and evaluation of the effectiveness of the training.
- In particular, with respect to internal quality and environmental auditors, RABQSA and ASQ provide certification of these auditors, so their work can be used by others.

Comment # 6: page 26: “Walkthroughs require the auditor to "get out of the audit room" and interact with those responsible for internal control from day to day. They also provide the auditor with the opportunity to learn about the everyday activities of the company, which may not be reflected in any document that the auditor reviews.”

page 27: Question 27: “Is it appropriate for the auditor to use others as direct assistance in performing walkthroughs? Should the proposed standard allow the auditor to more broadly use the work of others in performing walkthroughs?”

QMS/EMS Comment:

- **QMS/EMS:** ISO 9001 and ISO 14001 internal auditors could act as guides for the SOX auditors in performing walkthroughs. Also, the work performed by quality and environmental auditors may contain valuable information for SOX auditors.
- ISO 9001 was designed for business processes, where an end-to-end walkthrough may be used and process driven auditing can be comprehensive for both Operations and Financial organizations.

Comment # 7: page A1-9: “Assessing company-level controls to sufficiently address risks of misstatement. A smaller and less-complex company might rely more frequently on monitoring controls performed by senior management to detect misstatements in certain assertions”

QMS/EMS Comment:

- **QMS:** ISO 9001, Clauses 8.2.3 and 8.2.4: require monitoring & measurement of processes and product. Clause 8.4 requires analysis of the data gathered. This often results in the identification of risks to the organization’s objectives. These results can be used by external auditors.
- **EMS:** ISO 14001, Clause 4.5.1 requires monitoring and measurement, on a regular basis, of the key characteristics of its operations that can have a significant environmental impact and Clause 4.5.2 requires evaluation of compliance. These results can be used by external auditors.

Comment # 8: pages A1-11 & A1-12: “Company level controls include: Controls to monitor results of operations.”

QMS/EMS Comment:

- **QMS:** ISO 9001, Clauses 8.2.3 and 8.2.4 require monitoring and measurement of processes and product. ISO 9001, Clause 4.2.4 requires

that records be legible, readily identifiable and retrievable and that a documented procedure be established to define controls needed for identification, storage, protection, retrieval, retention time and disposition of records. These results can be used by external auditors.

- **EMS:** ISO 14001, Clause 4.5.1 requires monitoring and measurement, on a regular basis, of the key characteristics of its operations that can have a significant environmental impact and Clause 4.5.2 requires evaluation of compliance. These results can be used by external auditors.

Comment # 9: page A1-12: “As part of evaluating the control environment, the auditor should assess – Whether management's philosophy and operating style promotes effective internal control over financial reporting.”

QMS/EMS Comment: This is typically called “Tone at the Top.”

- **QMS:** ISO 9001, Clause 5.1, Management Commitment, requires top management to communicate to the organization the importance of meeting customer as well as statutory and regulatory requirements, establishing the quality policy, ensuring that quality objectives are established, conducting management reviews and ensuring the availability of resources. These results can be used by external auditors.

Comment # 10: page A1-12: “As part of evaluating the control environment, the auditor should assess –Whether management and employees are assigned appropriate authority and responsibility to facilitate effective internal control over financial reporting.”

QMS/EMS Comment:

- ISO 9001, Clause 5.5.1 and ISO 14001, Clause 4.4.1 require that top management define responsibilities and authorities and that they communicate them within the organization. These results can be used by external auditors.

Comment # 11: page A1-17: “The auditor should follow the process flow of actual transactions using the same documents and information technology that company personnel use.”

page A1-20: “Testing Design Effectiveness: Procedures the auditor performs to test design effectiveness include a mix of inquiry of appropriate personnel, observation of the company's operations, and inspection of relevant documentation.”

page A1-20: “Testing Operating Effectiveness: Procedures the auditor performs to test operating effectiveness include a mix of inquiry of appropriate personnel, observation of the company's operations, inspection of relevant documentation, walkthroughs, and re-performance of the control.”

QMS/EMS Comment:

- The work of ISO 9001 and ISO 14001 auditors provides valuable information for the SOX auditors. The QMS/EMS internal auditors could act as guides during a SOX audit.

3.0 Comments on “Considering and Using the Work of Others in an Audit”

Comment # 12: page A2-3: “1. For these purposes, the work of others includes work performed by internal auditors, company personnel (in addition to internal auditors), and third parties working under the direction of management or the audit committee.” **QMS/EMS Comment:** “company personnel” includes quality and environmental system auditors, IT auditors, and business process owners.

Comment # 13: page A2-3: “3. The auditor should obtain an understanding of work performed by others sufficient to identify relevant activities.”

QMS/EMS Comment: The QMS/EMS has documented procedures and a record trail to define the functions of QMS/EMS auditors, their work papers and reports.

- **QMS:** ISO 9001, Clause 8.2.2, Internal audit, and **EMS:** ISO 14001, Clause 4.5.5, Internal audit, provide the auditable framework. This framework is used world-wide by third-party certification bodies or Registrars.

Comment #14: page A2-5 “10. To use the work of others to reduce the nature, timing, or extent of the work the auditor would have otherwise performed, the auditor should –b. Evaluate the competence and objectivity of the individuals who performed the work;”

QMS/EMS Comment: In the U.S., the competence of internal quality auditors can be certified by RABQSA or ASQ.

Comment #15: page A2-5 “13. Evaluating the Competence and Objectivity of Others. The auditor should evaluate the competence and objectivity of the individuals performing tests of controls, accounts, or disclosures to determine the extent to which the auditor may use their work.”

QMS/EMS Comment: In the U.S., the competence of internal quality auditors can be certified by RABQSA or ASQ.

Comment #16: page A2-7 “15. b. The organizational status of the persons responsible for the work of others, including – • Whether the responsible persons report to a person of sufficient status to ensure sufficient testing coverage and adequate consideration of, and action on, the findings and recommendations of the persons performing the testing.”

QMS/EMS Comment: In many companies, the internal quality and environmental audit organizations are designed to be free of bias based on the organizational structure.

4.0 Summary and Conclusions

In response to the request from the PCAOB for comments we have established a role for quality and environmental management and auditors in support of an organization’s compliance to SOX. In addition, because of top management and the Board of Director

interest in compliance, our comments will provide them with a better understanding of quality and environmental management systems capabilities.

The American Society for Quality is the largest quality organization in the world. The observations and recommendations in this letter are meant to have broad application in the public and private sectors throughout the world. Quality and environmental management systems provide valuable inputs to an organization's financial structure that help maintain its competitiveness in the global economy. The ASQ SOX Team will be pleased to provide further details on the comments in this letter.

Respectfully submitted,

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