



December 17, 2007

Via email to:

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

RE: Preliminary Staff Views – October 17, 2007

Dear Office of the Secretary:

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB) Preliminary Staff Views – An Audit of Internal Control that Is Integrated with an Audit of Financial Statements: Guidance for Auditors of Smaller Public Companies.

Tatum LLC is the largest and fastest-growing executive services firm in the United States providing clients with, among other professional services, Sarbanes-Oxley compliance and consulting services. Tatum, like many other professional services firms, has been on the frontline with the Sarbanes-Oxley Act since it was passed in 2002. This experience has enabled us to see full well the challenges that companies have faced and are currently experiencing with initial compliance as well as on-going monitoring.

Overall, we believe that the adoption of Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting that Is Integrated with an Audit of Financial Statements* (AS 5) will have a significant impact on the way in which auditors perform their audits of the financial statements and internal control over financial reporting (ICFR). In our letter dated February 26, 2007 in connection with the proposed AS 5 (PCAOB Rulemaking Docket Matter No. 021), a number of our comments related to providing more specific and practical guidance and examples, particularly in the area of integrating the audits and scaling for smaller companies. We applaud the PCAOB's effort to provide practical guidance for implementing AS 5 to audits of smaller, less complex organizations.

Following are our observations and suggestions for your consideration. We have organized them into the two specific questions posed in the invitation to comment.

Responses related to Question 1 – Does the guidance in this publication, including the examples, appropriately consider the environment of the smaller, less complex company? If not, what changes are needed?

For the most part, the guidance and examples in the publication appear to adequately consider the control environment of smaller, less complex companies. While page five of the document clearly states that it is "not intended as guidance to management regarding establishing or evaluating internal controls over financial reporting," it is important to note that, in practice, auditors will refer to the examples in attempting to identify controls and in making control recommendations to management. In addition, while there are specific and appropriate references to, and adaptations of, the COSO Guidance for Small Businesses, companies that wish to increase or maximize auditor reliance on the work performed by management or others on behalf of management will also refer to this guidance to facilitate those discussions. We have provided suggestions below related to certain examples contained in the Staff Views that may present practical challenges or that we believe warrant additional clarification.

Example 2-2

The entity-level control in this scenario could operate at a slightly lower level in a more complex company while arguably having the same impact on the testing of other controls. To illustrate, the CFO who has a thorough understanding of the business processes, including payroll, performs a review of the weekly payroll summary reports prepared by the centralized accounting function, identifies improprieties and investigates whether misstatements have occurred. At a larger more complex company, the same review may be performed by a divisional controller who has a comparable level of knowledge of the divisional business processes, including hiring and terminations of the division. All facts being identical, it would seem that the auditor could conclude that the review by the divisional controller could detect misstatements related to payroll processing of the division.

Example 3-1

With respect to some of the controls noted in Example 3-1, we have found in practice that many companies, under the guidance of general counsel, have implemented strong risk management and documentation policies that limit retention and detailed documentation of certain information that may include detailed minutes of executive session. We recommend acknowledgement of this and/or modification of the example to include more reliance on inquiry and observation (as appropriate) in these situations and reference to the use of agendas versus minutes (if no minutes are kept for these particular meetings or not kept in sufficient detail).

Example 5-1

The current wording in the Audit Approach section may create confusion, particularly in the second main bullet. We believe this example needs to clarify that the controls being tested (to establish reliability of reports) relate to those reports used in the “alternative control” (senior management’s reviews and analysis), not the controls over transaction processing (thus reports generated) that were deemed ineffective due to incompatible duties (e.g., lack of SOD). In addition, we suggest that the example be expanded to include examples of those reports and/or controls including analytics (KPIs or other) that are of a sufficient precision and reliability.

On page 36, the first full paragraph and bullets relate to use of outside professionals, and the third bullet specifically states that “Management is not required to possess the expertise to perform or re-perform the services.” We have observed significant challenges in this area in practice and believe that more detailed practical examples (in addition to example 6-1) are warranted. Some specific examples that may be helpful are situations where the company uses an outside party for assistance in accounting for stock compensation in accordance with FAS 123R, financial instruments such as derivatives or hedging (not as a service organization), FIN 46 analysis, and/or for financial statement preparation. Example 6-1 refers to a situation where the company prepares a preliminary provision, we suggest an example in which the company doesn’t prepare it, but rather, the outside firm/party prepares the provisions and related deferred asset/liability information and the company reviews it as this is what we typically see most often in practice with smaller companies. Please see additional comments below related to Example 6-1.

Example 6-1

The Audit Approach section refers to confirmation that the data used by the third-party is complete and accurate; however, we suggest that the “scenario” section should also contain reference to this as the facts must exist in the scenario in order to be considered in the Audit Approach. In addition, we have often seen a lack of controls in this area (confirming that final financial information was used) particularly in companies that are very spreadsheet and/or top-side adjustment driven because version control issues may lead to inaccurate or preliminary data being used in the calculation. This is typical in smaller, less sophisticated organizations.

Example 7-1

We recommend expanding the example to encourage consideration of any existing documentation, including desk reference or notes used by the person who performs the control and/or any documentation created in support of management’s assessment of ICFR. Similar comments are made throughout this letter with respect to encouraging auditors to consider the availability and **substance** of existing documentation rather than the **form** to improve efficiency and limit inefficient or unnecessary procedures on their part that simply serve to create additional/duplicative documentation in a different form.

Example 7-2

Understandably, many auditors have historically been reluctant to place reliance on controls in which there is little or no documented evidence of occurrence, especially for high risk pervasive controls. Example 7-2 provides an audit strategy related to how an auditor may obtain evidence for the period-end financial reporting process through inquiry with the CFO, review of comments sent to the controller and observing the CFO’s review with the audit committee. Given that the audit evidence will be comprised primarily of inquiry and observation, many auditors may feel that the evidence is not sufficient given the significance of the CFO’s review and the risk associated with the period-end financial reporting process, as well as current audit requirements in connection with evaluating the financial statement close process.

As previously noted, (1) these examples will be referred to by auditors in making recommendations to management, and (2) we have observed in practice that many companies have implemented strong policies related to retention/destruction of prior versions of financial statements and related notes. Therefore, the description of the control in which the CFO retains copies of prior versions of the financial statements with her notes may not be practical or appropriate as the evidence may only exist at a certain point in time. We recommend modification of the example to acknowledge this and/or to provide additional guidance that refers to the many meetings or conversations, and related changes or journal entries that occur throughout the review process. Thus demonstrating that much of the evidence may be provided through inquiry and observation including the auditor involvement in the process of reviewing the black-line versions of the financial statements and related filings at the time they are generated. In addition, the example could refer to guidance provided elsewhere in the Staff Views regarding evidence that only exists at a certain point in time.

We recommend additional examples or guidance related to certain matters within the responses related to question 2 below.

Responses related to Question 2 – Are there additional audit strategies or examples that the staff should consider including in this publication? If so, please provide details.

We recommend stronger guidance and more frequent reference related to consideration of documentation and evidence of control design that exists within the company – particularly documentation that may have been developed in connection with and in support of management’s assessment report. This guidance should include practical examples and strong language related to considering the content and substance of the documentation over the form. As briefly noted in comments related to Example 7-1 above, we have experienced situations in which auditors have refused or have been reluctant to “accept” documentation prepared by the company if it is not in the form contemplated by their historical approach or their audit methodology. For example, for a relatively non-complex, lower risk process, management may have developed a risk and control matrix that identified the individual risks and controls over financial reporting associated with the specific relevant assertions; however, the auditors insisted that a detailed narrative (and in some cases a flow diagram) was also necessary in order for them to use or rely on the work performed by the company. In certain cases, auditors attempted to “prescribe” the format the company should use to document controls and/or in the absence of compliance with their request, they may perform additional work to develop this documentation resulting in a largely duplicative and inefficient effort. In addition,



certain auditors provided comments to companies requesting grammatical or editorial changes to the company's documentation. This information may be particularly relevant within the Audit Strategy Considerations section (see additional comments related to that section further below)

We also recommend that additional examples and guidance be provided with respect to tailoring the audit approach related to the audit of ICFR versus the audit of the financial statements when controls change during the year. We believe this is an area where greater efficiency and effectiveness could be gained with proper examples. We have observed situations where auditors applied the same control testing criteria (e.g., sample sizes, nature, timing and extent) to both the controls in place earlier in the year and those in place at the end of the year. It has not always been apparent and they have not always been able to articulate that there was a corresponding reduction in substantive procedures either under the previous or the latest control structure; therefore, the effort appeared largely duplicative. While this certainly applies to larger organizations (especially those involved in M&A activity), it is particularly important in smaller organizations that are experiencing rapid growth because their control environments are often dynamic with frequent changes in personnel, operations, business processes, and IT systems. Paragraph 3 on page 10, as currently worded, may create additional confusion regarding this matter. We recommend additional language and examples related to effective and efficient audit strategies in these situations.

On page 10, the last two paragraphs may create confusion when compared and contrasted because the last paragraph implies that if the auditor determines substantive procedures are more effective and efficient than relying on controls, they may test fewer controls in support of the ICFR opinion; however, it is not clear whether that means a fewer number of individual key controls overall will be tested or that sample sizes may be reduced. This comment also applies to the last paragraph on page 40 that refers to choosing to test one of two controls, that being the one for which evidence can be obtained more readily. In practice, we have observed that audit firms generally tend to test **all** key controls for purposes of the ICFR opinion and that they have fairly standard sample sizes and metrics related to testing those controls for the purposes of an opinion on ICFR, thus this very individualized approach seems very challenging to implement and to evaluate from an effectiveness and efficiency standpoint. This may improve as AS 5 implementation progresses, but specific and practical guidance would serve to further this effort.

There are a number of paragraphs within the guidance that refer to whether controls are designed or operating effectively to "prevent or detect on a timely basis misstatements in one or more assertions that could cause the financial statements to be materially misstated." We believe that more of these paragraphs should also include reference to the timely correction of errors that are detected. In practice we have observed controls that appear to be adequately designed and operating, but upon further investigation, the identified errors were not resolved in a timely manner. For example reconciling items may have been identified on a timely basis, but they continued to be carried forward on reconciliations in multiple periods. This comment is particularly relevant to page 14 within the full paragraph as well as the bullet related to purpose of the control.

On Page 32, the second paragraph under Application Controls could be clarified to indicate whether the "test fewer items" reference refers to testing fewer controls overall or to reducing sample size.

We recommend that the Audit Strategy Considerations section and related examples on pages 38 – 42 be expanded to address reliance strategies in sufficient detail, both as it relates to documentation of the design of controls as well as testing/evaluation documentation. With respect to our previous comments regarding substance versus form of control design documentation, we specifically suggest expanded discussion and examples related to how the auditor may use the documentation of controls design created by management in connection with their evaluation for purposes of management's assessment. We also suggest additional guidance regarding strategies for using the work of others within smaller organizations, particularly as it relates to walkthroughs and testing. While we have generally seen significant improvements in both of



these areas over the years, this guidance applies to all audits of ICFR, regardless of size and complexity. However, there are additional effectiveness and efficiency considerations as it relates to smaller organizations because some may benefit greatly from increased reliance, while others may not. Some of this is certainly addressed in the guidance on using the work of others; however, given the limited resources of smaller organizations, they often face unique challenges in obtaining the level of “competent, objective and independent” testing evidence at a sufficient level to maximize auditor reliance. In addition, we recommend expanding the paragraph at the top of page 40 to include some additional practical scenarios and examples.

In connection with the first comment in this section (responses to question 2), with respect to the Appendix, we suggest that significant discussion be added related to using evidence available in connection with management’s assessment. For example, the planning and risk assessment sections contain no reference to review, coordination or discussion of management’s materiality, risk assessment and scoping activities as a basis or validation of the auditors activities. The approach as currently documented implies that the auditor’s activities should occur independently and without any consideration of management’s work or the work performed on behalf of management. This comment is applicable to the entire appendix because except for one minor comment in the first paragraph on page 51, references to using the work of others or information available from management’s assessment is absent. In order to fully reconfirm the guidance in AS 5, we encourage adding these points of consideration and communication to the entire discussion throughout the Appendix as we have observed in practice that open communication between management and the auditors early and often, and proper planning to reduce duplicative and inefficiencies enhances the effectiveness and efficiency of the compliance and audit effort.

Overall, the guidance provides audit strategies that are tailored to the smaller company environment. However, we believe that the challenge will be in the implementation of the guidance as most public accounting firms have a fairly standardized audit methodology that is used for all audits of internal control regardless of size or complexity as it generally promotes quality and consistency. In developing their audit strategies, most auditors will feel compelled to ensure that their audit is in compliance with their firm’s methodology and will generally only consider alternative procedures when their methodology allows such judgment to occur and provides sufficient guidance. Unless audit firms are able to update their audit methodology in a timely manner and provide for the consideration of the audit strategies proposed in the guidance for smaller, less complex companies, many auditors may not fully implement the recommendations.

We believe that some of the provisions of the Staff Views publication, especially those regarding the use of entity-level controls to achieve control objectives, are applicable to all audits regardless of size and complexity, and encourage the PCAOB to consider providing additional practical guidance that can be used for all audits.

We appreciate the efforts being made by the PCAOB to ensure audit quality and efficiency. Again, we appreciate the opportunity to comment on the preliminary staff views and are available to talk or meet with you to clarify any of our comments.

Sincerely,

A handwritten signature in black ink that reads 'Kathy Schrock'.

Kathy Schrock, Partner
National Practice Leader – Internal Control and Risk Solutions
National Sarbanes-Oxley Subject Matter Specialist
Tatum LLC