

I would like to keep this input anonymous. It represents my personal viewpoint after many years in Internal Audit and many other years in general business and corporate governance. Some of the following comments raise questions for the external audit community and I do not wish for my personal comments to affect in any way the business relationship my company has with our external auditor, one of the big four and a very good one at that.

The subject of this note is on SOX section 404 and more specifically on the external auditor's attestation as to management's assessment of the internal control structure over financial reporting. At the risk of breaking my arm patting myself on the back, I think you will find the note reasoned and of value.

The issue is to the view of Congress, in writing 404, on the size and nature of the work that would be required to position the external auditor to be able to provide the attestation. There are many factors in this issue, and there is already much input to the SEC and PCAOB. For my purposes, these are most notably from the AICPA and the FEI.

In one of its submissions to the SEC, the FEI cited Senate Report No. 107-205 on S-O and quoted "In requiring the registered accounting firm preparing the audit report to attest to and report on management's assessment of internal controls, the Committee does not intend that the auditor's evaluation be the subject of a separate engagement or the basis for increased charges of fees."

The FEI also expressed a growing concern that the PCAOB would hastily adopt auditing and attestation standards that would be set solely by the AICPA's Auditing Standards Board. It further complained about the inherent conflict therein and the increasing level of marketing by public accounting firms offering consulting services on compliance with the internal control attestation requirement that they themselves were defining.

The PCAOB offers some help in this regard. In its release No. 2003-005, "Statement Regarding the Establishment of Auditing and Other Professional Standards" we find on Page 12 the following:

### "3. Review of Internal Controls and Section 404 Attestation Standard

In addition to the matters listed above, Section 103 (a)(2)(A)(iii) of the Act also requires the Board to adopt auditing standards that require registered public accounting firms to -

'describe in each audit report the scope of the auditor's testing of the internal control structure and procedures of the issuer, required by section 404(b), and present (in such report or in a separate report) -

- (I) the findings of the auditor from such testing;
- (II) an evaluation of whether such internal control structure and

procedures -

- (aa) include maintenance of records that in *reasonable detail* accurately and fairly reflect the transactions and dispositions of the assets of the issuer;
  - (bb) provide *reasonable assurance* that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the issuer are being made only in accordance with authorizations of management and directors of the issuer; and
- (III) a description, at a minimum, of *material weaknesses* in such internal controls, and of any *material noncompliance* found on the basis of such testing." (my emphasis applied)

In contrast, in reviewing the ASB's Exposure Draft and Proposed Statement on Auditing Standards and Auditing An Entity's Internal Control Over Financial Reporting in Conjunction With the Financial Statement Audit Page 4 of 16, paragraph 7 we find:

"For the purpose of expressing an opinion on internal control, tests of controls that the auditor performs should be sufficient to obtain a *high level of assurance* about their operating effectiveness."

In additional guidance from the AICPA, their "Key Issues For Management" of March 13, 2003 states:

"An audit (or examination) of the effectiveness of internal control over financial reporting will most likely require *significantly more work* than what the auditor was doing previously with respect to internal control in a financial statement audit, because an audit of internal control requires testing of a broader range of controls as well as sufficient testing to obtain *a high level of assurance about their operating effectiveness*. . ." (Again, my emphasis applied)

As I read this, the SOX legal requirement for external audit's opinion on reported financials is to "provide *reasonable assurance* that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles" while the AICPA proposed standard for 404 attestation is "tests of controls that the auditor performs should be sufficient to obtain a *high level of assurance* about their operating effectiveness."

In other words, the proposed testing of the controls over processes that lead to the audited financials are against a higher standard than the audited financials themselves. I don't believe this is what the authors of Sarbanes-Oxley intended. I also don't believe it is necessary to have more testing for the attestation than is required on the financial reports. It just doesn't make sense. Respectfully offered this 13<sup>th</sup> day of May, 2003.