



Pension Reserves Investment Management Board

84 State Street, Second Floor
Boston, Massachusetts 02109

Timothy P. Cahill, Chair
Michael Travaglini, Executive Director

February 23, 2007

Office of the Secretary
PCAOB
1666 K Street, NW
Washington, D.C. 20006-2803
Re: PCAOB Rulemaking Docket Matter No. 021

Dear Sir or Madam:

On behalf of the Pension Reserves Investment Management (PRIM) Board, which manages some \$46.7 billion on behalf of past and present public employees in the state of Massachusetts, I wish to share our views on the PCAOB's proposed auditing standard for implementation of Section 404, the internal controls provisions of the Sarbanes-Oxley Act of 2002.

First, allow me to share PRIM's strong support for Sarbanes-Oxley, which we believe has played a critical role in re-establishing public trust in U.S. capital markets and the reliability of financial data provided by publicly-traded companies following the financial frauds at Enron, Worldcom and other major corporations. Looking back, it is evident that these frauds were easier to perpetrate and more difficult to uncover because of weaknesses in the companies' internal controls over financial reporting. We believe that Sarbanes-Oxley, particularly Section 404 requirements for enhanced management reporting and an independent external audit of internal controls, has substantially strengthened the internal controls of companies that have filed reports under Section 404.

At the same time, we recognize that implementation of the new law has not been perfect. We applaud the Board's efforts to improve both the auditing standard for Section 404 and its implementation by independent auditors. We believe that the proposed new rules should eliminate unnecessary work, enhance efficiency and reduce Section 404 costs for many public companies.

But much as we support efforts to reduce unnecessary costs, we also believe that investor protection must remain the Board's overriding objective in implementation of Sarbanes-Oxley. We further believe that the Board's current proposals maintain the appropriate balance, and we urge the Board to resist any adjustments that might expose investors to unnecessary risks in the name of cost-cutting. We must not allow cost considerations to become the driving force behind Sarbanes-Oxley or Section 404.

PRIM believes that investors in both small and large companies are equally entitled to appropriate assurances about a company's financial data and internal controls. Smaller

companies have historically been somewhat more prone to both financial fraud and misstatements than larger companies. This tendency has been exacerbated by the relatively slower implementation of Section 404 for the smallest companies. According to recent data collected by Audit Analytics, the number of restatements by companies with market cap of less than \$75 million continued their steady growth during 2006. Restatements by these smaller companies climbed by 42 percent last year and accounted for more than two-thirds of all restatements by U.S. public companies. While we agree that audits should be scalable to reflect company size, scalability does not mean a lower standard should apply.

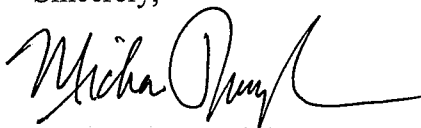
We certainly agree that auditors should strive for efficiency and seek to avoid unnecessary work and expense in performing internal controls audits. But, in our view, it is even more important that the audit is performed effectively. Efficiency must not take precedence over effectiveness. We urge the Board to make clear that it will stand by auditors' exercise of reasonable professional judgment in achieving an effective audit.

In particular, we believe decisions about the reliance on the work of others fall squarely in the realm of professional judgment. Excessive reliance on others' work could compromise the effectiveness of the audit.

In addition, we urge the Board to reject any suggestions for selective or rotational testing of key controls. We believe that key controls must be tested by the auditors every year. It would violate our collective obligations to investors and undercut the core goal of Section 404 to permit any unverified *assumption* that key controls are operating as intended.

Once again, we commend the Board on its efforts to properly balance competing imperatives. Moving forward, we urge the Board to resolve conflicts between efficiency and effectiveness by standing firmly on the side of investor protection. Short-term cost savings have their appeal, but the long-term consequences of stripping away needed protections would be enormous. Strong capital markets are essential for America's economic prosperity. The markets, in turn, depend on investor confidence. To keep capital markets and our economy strong, we urge this Board and all policymakers to continue to stand up for investors.

Sincerely,

A handwritten signature in black ink, appearing to read "Michael Travaglini", with a stylized flourish extending to the right.

Michael Travaglini
Executive Director

Pension Reserves Investment Management Board