



Small and Mid-size Public Companies Committee

December 14, 2007

J. Gordon Seymour
Office of the Secretary,
Public Company Accounting Oversight Board
1666 K Street, N.W.,
Washington, DC 20006-2803

Submitted via email to: comments@pcaobus.org

RE: Preliminary Staff Views – October 17, 2007"

Dear Mr. Seymour,

Financial Executives International's ("FEI's") Small and Mid-size Public Companies Committee ("FEI SMPCC") appreciates the opportunity to provide its views on the Public Company Accounting Oversight Board's ("PCAOB's") "Preliminary Staff Views - An Audit of Internal control That is Integrated With An Audit of Financial Statements: Guidance for Auditors of Smaller Public Companies," (the "Preliminary Staff Views" or "PSV").

FEI is a leading international organization of 15,000 members, including Chief Financial Officers, Controllers, Treasurers, Tax Executives and other senior financial executives. FEI SMPCC is a committee of FEI, which reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations, from the perspective of small public companies. This document represents the views of FEI SMPCC, and not necessarily those of FEI or its members individually

General support for emphasis on how controls at small companies can differ, and examples

In general, we strongly support the PSV's emphasis of five major areas where smaller, less complex companies may achieve the objectives of internal control differently from large, complex companies. These are: use of entity-level controls, risk of management override, implementation of segregation of duties and alternative controls, use of information technology, maintenance of financial reporting competencies (which the PSV helpfully notes may include consideration of third party assistance), and nature and extent of documentation.

These factors properly recognize the importance of 'tone at the top'. We also believe the approach taken in the PSV to provide examples of application of the guidance is helpful.

Concern about overly prescriptive approach to 'precision'

However, we are concerned about the PSV's highly prescriptive approach to defining the term 'precision.' The term 'precision' was first used in AS5 (in the discussion of entity-level controls) and was used once in the SEC's companion interpretive guidance for management (also in a section referencing entity-level controls) but was not used previously in AS2.

Although it is arguable whether the term 'precision' was overly prescriptive in and of itself, and whether it potentially furthers an expectation gap of precision vs. reasonable assurance, the fact that it resides in AS5 and the SEC guidance does not mean the PSV should define the term in a highly granular way that can limit the use of professional judgment. The 'factors' of precision listed on pages 14-15 in Chapter 2 of the PSV run the risk of driving a check-the-box approach.

The fact that the PSV says the list of factors "might" be considered by auditors is not a strong confidence builder that auditors will not revert to adopting the checklist of factors as a de facto requirement.

Additionally, we believe some of the factors, specifically, 'level of aggregation' and 'consistency of performance,' by trying to translate a qualitative characteristic into a quantitative one, can sometimes provide 'false negatives' or reject the validity of certain entity-level controls that are very effective. Indeed, we are concerned the highly prescriptive approach in the PSV of defining factors of precision may lead some auditors to try to quantify the level of precision for various controls by assigning numerical values to them. The effort put into such a bright line approach, we believe, will not be efficient nor effective; it runs the risk of being overly granular in its approach.

For example, the PSV's discussion of 'consistency of performance,' by stating 'routinely' performed controls are generally more precise than 'sporadically' performed controls, implies ongoing controls or testing are generally more precise than separate controls or testing, and that may not be the case. For smaller companies in particular, the frequency at which a control operates will not necessarily be indicative of its preciseness.

Further, we believe the emphasis on 'preciseness' may divert attention away from the need to focus on a top-down, risk based approach.

To address the concern described above, we recommend the PSV delete the discussion of "Assessing the Precision of Entity-Level Controls," and look for a more top-down, risk-based approach to testing entity level controls.

We have three additional observations with respect to the PSV:

Monitoring

The PCAOB can consider noting that COSO is currently working on a project to develop guidance for management on use of the monitoring component of internal control, and auditors may wish to reference that guidance to help integrate the audit of internal control and make it as efficient and effective as possible.

Information technology

In some situations, less sophisticated systems may not have internal controls built into the software. In those situations, alternative controls may be applied, or there may be implications on the balancing of substantive testing vs. reliance on internal control. Additionally, the discussion assumes companies are relying on certain controls, when they are not.

We agree with chapter 5 of the PSV in its characterization of less complex IT environments in smaller companies, as well as its identification of the IT-related risks affecting financial reporting. We believe, however, that the PSV does not go far enough in encouraging auditors to apply the broader principles outlined in the other chapters in their audit of IT general controls, IT-dependent controls, and automated controls.

Chapter 5 of the PSV should take the opportunity to extend the discussion of entity-level controls to entity-level *IT* controls. Entity-level IT controls, such as IT steering committees, change control boards, and monitoring, may reduce the need for testing of IT general controls. Similarly, in planning its audit of IT controls, auditors should consider the likelihood that controls will be ineffective, the availability of documentation and evidence to ascertain operating effectiveness, and IT competencies within the organization. Auditors should also be encouraged to identify segregation of duties issues in IT early on in the audit process.

Furthermore, it is our concern that the PSV does not sufficiently emphasize the importance of evaluating IT-related risks in the broader context of a smaller company's overall control objectives. The extent to which a company relies on IT general controls may be reduced by the existence of alternative controls. Transactional processes may be handled by IT systems, but by virtue of the fact that inputs and outputs may be more easily reconciled in less complex environments a company may rely more heavily on financial reconciliations rather than IT general controls in attaining its control objectives.

On a more specific note, the PSV does not sufficiently discourage check-box audits of IT controls. For example, many smaller companies may lack formalized change management programs for applying patches to common off the shelf software. By itself, this might appear to be a deficiency in IT controls, however, the existence of a robust incident response program (to include feedback from application users) and robust back-up procedures may sufficiently mitigate the risks inherent in less formal change management procedures.

Reliance on substantive audit vs. controls

Page 9 of the PSV notes that, “Historically, the approach for financial statement audits of smaller less complex companies has been to focus primarily on testing accounts and disclosures, with little or no testing of controls.” The PSV then states “The internal control reporting requirements under Sections 103 and 404 of the Sarbanes-Oxley Act give auditors the opportunity to re-consider their traditional approach to the financial statement audit portion of the integrated audit.”

We believe it is important to point out that this “opportunity” may not be cost effective. There are often disproportional costs for small, less complex companies associated with establishing internal control systems that mirror those of larger companies. Therefore we believe the historic approach of relying significantly on substantive audit testing vs. controls will still be a major factor for small companies, and the key will be in properly balancing and integrating the work done to achieve an integrated audit of the financial statements and internal control.

This point can be clarified in the PSV. We recommend bringing forward into the last paragraph of the Scaling section of Chapter 1 the scope limitation discussion of Chapter 8, “Even if the auditor lacks sufficient evidence to express an opinion on internal control, the auditor might still be able to obtain sufficient [substantive] evidence to perform an audit of the financials”

FEI's SMPCC greatly appreciates the PCAOB's efforts to make reporting under Sarbanes-Oxley Section 404 more efficient and cost-effective, and we thank you for considering our views. We would be happy to discuss our comments and recommendations at your convenience. If you have any questions, please feel free to contact me at Karen@rasgroup.net or Serena Dávila, sdavila@financialexecutives.org, Director, Technical Activities, in FEI's Washington DC office, if you have any questions or wish to discuss.

Sincerely,

A handwritten signature in black ink that reads "Karen Rasmussen". The signature is written in a cursive, flowing style.

Karen Rasmussen
Chair, Small and Mid-Size Public Company Committee
Financial Executives International