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# Memo

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To: SEC and PCAOB Roundtable on Internal Control Reporting Requirements Participants

From: Carl D. Mautz, Vice President and Chief Financial Officer

Subject: **SEC and PCAOB Roundtable Submission**

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**Issue:**

What type of evidence is needed for the external auditors to rely primarily on entity-level controls and to significantly reduce the amount of testing performed on low risk, routine, transaction processing controls?

**Background:**

*Requires Change in Approach for External Auditors*

External auditors continue to rely on both the detailed testing of transaction processing controls as well as entity-level controls to support their SOX 404 opinions over the design and operating effectiveness of internal controls over financial reporting. There is a perception, which may be reality, that the external auditors will be taking on more risk if they do less testing in support of their SOX 404 opinions. Additionally, if the external auditors reduce the overall amount of their testing, they will also reduce their billable hours and associated fees.

*Excessive Resources Focused on Low Risk, Routine Areas*

Many of the low risk, routine, transaction processing controls have a multiple-times-per- day frequency. Therefore, the samples tested by both internal audit to support management's assertion and the external auditors generally range from 20-60 items, as required by current U.S. auditing standards. A significant amount of time is spent running population reports, selecting samples, providing documentation for testing, answering follow-up questions, and documenting test results. For companies with established internal audit departments that perform company-wide testing on a rotational basis, there is no value associated with the continuous extensive testing of low risk, routine, transaction processing controls. Either the SEC or the PCAOB must take a more active role in changing the standards for auditing internal controls over financial reporting, because the independent public accounting firms have little incentive to do so.

*Corporate Scandals Resulted from Entity-Level Control Breakdowns*

The high profile, corporate scandals such as Enron and WorldCom resulted from breakdowns in governance, entity-level controls and period-end reporting controls. The multi-million dollar frauds did not occur because of breakdowns in low risk, routine, transaction processing controls.