March 29, 2005

To Whom It May Concern:

In my opinion, there are two changes that could be made to the Sarbanes Oxley legislation that could substantially reduce the effort and cost to comply with the law without substantially reducing the perceived benefits from the legislation. My comments only relate to Rule 404—Controls over Financial Reporting and not to the entire Sarbanes Oxley Act.

The Sarbanes Oxley Act currently requires management to make an assessment as to the effectiveness of its controls over financial reporting. In addition, the Act requires the company's audit firm to make two opinions: 1) a similar assessment on the company's controls over financial reporting, as well as 2) an attestation as to the adequacy of management's assessment. Currently, the audit firms are following the guidance stated by the PCAOB to make their assessment and to attest to the adequacy of management's assessment. There is no similar guidance applicable to management. As a result, in most cases, management follows the same guidance that the audit firms are following. Thus, management and the audit firms are performing the same work twice, but independent of each other. This seems to be too excessive.

Another approach that should be considered is to have management perform procedures to prepare their assessment and simply have the audit firms “audit” management’s assessment. This would eliminate the requirement of having the audit firms prepare their own assessment. The appropriate guidelines that management should follow to make their assessment should be dictated from the appropriate governing body. These guidelines could simply be the same as the guidelines that the PCAOB has already promulgated for the audit firms.

Although the cost of complying with Rule 404 would be substantially reduced if the need for the company's audit firm to make an assessment was eliminated, I would argue that the benefit perceived from Rule 404 would not be substantially diminished. Management would still be performing the same work that was performed prior to the change in the requirement. In addition, the company's audit firm would be performing the same procedures to verify that management's assessment is accurate. The company's audit firm would still be acting as the independent “set of eyes” over management, similar to their role over the accuracy of a company's financial statements. It seems that the marketplace would still be able to rely on the audit firm's opinion on the company's assessment in the same manner, even if the audit firms own independent assessment was eliminated.
Secondly, PCAOB's Auditing Standard 2 should be challenged to assure that its requirements are in line with the intent of the Sarbanes Oxley legislation. Although the Sarbanes Oxley legislation gave the PCAOB the authority to promulgate rules related to Rule 404, it appears from a practical standpoint that the rules are stringent and require great effort and cost to comply. For example, AU 2 requires the company's audit firm to prepare a walkthrough of each process identified within a company's accounting system each year. The audit firm can't rely on the work of others in this area. In addition, the walkthrough must be prepared each year rather than be rotated over a two or three year period. This requirement adds a significant amount of cost compared to the benefit of the requirement. An example of AU 2 being excessively stringent and impractical is the fact that a company's auditor can no longer be considered another ‘set of eyes' during the review process of the company's Annual Form 10-K. It is unreasonable to remove the ‘accounting experts' from this process and it is impractical to not have your auditor involved early in the review process. A company cannot wait until a draft of the document is in its final form to have their auditor begin their review. The auditor must be involved in earlier drafts of the document. These drafts might contain mistakes that more than likely would be corrected by the company later in the process. The fact that the auditor might find a mistake in an early draft of the document should not be a cause for concern, but it puts the auditor in a difficult position regarding their assessment.

In conclusion, in my opinion, the above two suggestions for change in the current Rule 404 requirements would substantially reduce the effort and cost of compliance without reducing the perceived benefit of the law.

Sincerely,

Randall Mays