Computer Sciences Corporation

Leon J. Level
Vice President and Chief Financial Officer

November 21, 2003

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W., 9TH Floor
Washington, DC 20006-2803

Re: PCAOB Rulemaking Docket Matter No. 008, "Proposed Auditing Standard – An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements"

FILED ELECTRONICALLY (comments@pcaobus.org)

Dear Board Members and Staff,

Thank you for the opportunity to comment on the Public Company Accounting Oversight Board's (the "Board") proposed rule, "Proposed Auditing Standard – An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements," Release No. 2003-017 (the "Proposed Standard"), which was issued October 7, 2003. We commend the Board on its comprehensive efforts to involve all relevant constituencies in formulating this auditing standard.

We have supported the efforts of the President, Congress and the Securities and Exchange Commission to enhance investor confidence in the integrity of our financial reporting system, including legislation and regulations requiring public companies to report on the effectiveness of their internal control. Accurate and reliable financial information is fundamental to investor confidence, and effective internal control over financial reporting plays an important role in assuring the integrity of financial reporting. However, even effective internal control provides only reasonable, not absolute, assurance financial statements are not materially misstated.

While audits of internal control over financial reporting may help improve investor confidence, it is important to balance the cost of these measures with resulting benefits. The proposed audit of internal control over financial reporting certainly would not have detected or prevented the egregious fraudulent financial reporting and business failures of the past two years if full financial statement audits were not sufficient to detect or prevent these abuses.

We are gravely concerned the Proposed Standard, in fact, will result in very significant costs, wholly disproportionate to the resulting benefits. Accordingly, we think the Board should use every possible means to mitigate the cost of these measures to registrants and, ultimately, investors.

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- We have significant concerns with the overly broad and all-encompassing nature of the proposed definition of a significant deficiency as any deficiency where the likelihood of potential misstatement is more than remote and the magnitude is more than inconsequential. Deficiencies with a potential misstatement of more than "an inconsequential amount" would encompass substantially all deficiencies. This would make it difficult to distinguish more significant deficiencies in internal control over financial reporting from matters of far less importance and those unlikely to recur.

- We also have significant concerns regarding the exhaustive scope of required audit procedures; unnecessary restrictions on reliance auditors may place on the work of management, internal audit, and others; and the prohibitively high cost of these audit procedures without commensurate benefits.

- We strongly suggest the Board reconsider proposed guidance regarding enumerated circumstances where there is a presumption each circumstance represents at least a significant deficiency and a strong indication of a material weakness.

- Finally, we think the issues requiring reconsideration are so significant and pervasive that we suggest the Board reissue the Proposed Standard upon revision for further public comment to give adequate consideration to the viewpoints of all affected constituencies.

We have provided further information regarding these concerns, as well as other significant comments, concerns and suggestions, in the following paragraphs. We also have included detailed responses in Exhibit I to the specific questions for which the Board is seeking comment.

<u>Definition of a Significant Deficiency</u>

We think the definition of a significant deficiency is far too broad and all encompassing. Deficiencies with a potential misstatement of more than an inconsequential amount would encompass substantially all deficiencies. This would make it difficult to distinguish more significant deficiencies in internal control over financial reporting from matters of far less importance. We also think use of such a vague threshold as "inconsequential" would result in fairly significant diversity in practice since there is no existing usage of this term in either auditing standards or generally accepted accounting principles. Furthermore, we think this definition would mandate a standard which is virtually, if not wholly, unachievable for any large, global corporation.

Scope of Required Audit Procedures and Reliance on the Work of Management, Internal Audit, and Others

Generally, we think the Proposed Standard requires an excessive scope of work for the audit of internal control over financial reporting in that it (1) mandates certain controls be evaluated directly by the auditor (2) restricts the extent of reliance which the auditor may place on procedures performed by management, internal audit, or others and (3) prohibits the auditor from relying on work performed in prior years. As a result, the Proposed Standard would result in substantial duplication of efforts as to audit procedures performed in prior years, as well as between audit procedures performed by internal auditors and the external auditor.

More specifically, the Proposed Standard requires the auditor to directly perform all procedures, and not rely upon efforts of management, internal audit, or others, in the following areas:

- Controls which are part of the control environment, such as controls designed to prevent and detect fraud;
- Controls over the period-end financial reporting process;
- Controls which have a pervasive effect on the financial statements, such as information technology general controls; and
- Walkthroughs for all of the company's significant processes.

In principle, there is simply no reason the auditor should not be able to place reliance on the efforts of others in evaluating these controls, provided the auditor has:

- Evaluated the competence, objectivity and independence of the persons performing such work (as required under Statement on Auditing Standards No. 65), and
- Reperformed such tests, or directly performed such independent tests, as are necessary to corroborate the results of such procedures.

We think these restrictions will unnecessarily materially burden the entire economy with excess cost.

The extent of reperformance and independent tests should depend upon: the results of the tests performed by others; materiality, risk of misstatement, and degree of judgment or estimation associated with the related account balance or disclosure; degree of judgment required to evaluate the operating effectiveness of the control, subjectivity of the tests, and pervasiveness of the controls. Such reliance is particularly appropriate where testing has been performed by internal audit in accordance with the Standards for Professional Practice of Internal Auditing issued by the Institute of Internal Auditors ("IIA"), and where the internal audit function is independent and objective. In fact, in most cases, the company's internal audit

personnel would be at least as well qualified, and in many cases better able, to evaluate these control areas than the external auditors based on their knowledge of the company's industry, business, practices and procedures, processes and information technology systems.

Furthermore, the auditor should be able to fully rely on work of experienced internal audit personnel for controls over significant non-routine and non-systematic transactions, such as accounts involving significant judgments and estimates, where such personnel are judged to be sufficiently competent and knowledgeable, as well as objective and independent from management.

Finally, the auditor should be able to place reliance on work performed in prior years where such work is relevant to the current period. An example of this would be tests of application program controls. If such controls are tested in connection with the initial implementation of a new system it would only seem necessary to test changes in subsequent periods, assuming the auditor has tested IT general controls (including program change controls) and determined such controls are effective. This approach is referred to as "baselining" application controls and is a long established, widely accepted practice in use in audits of service providers under Statement on Auditing Standards No. 70 ("SAS 70 audits"), as well as audits of IT controls in conjunction with audits of financial statements.

Cost Benefit Considerations

Based on the various factors discussed above we think the cost of audit work required under the Proposed Standard does not appear to be reasonable in relation to the benefits to be achieved. Financial Executive International estimates potential annual audit cost increases of 30-50%. Representatives of the big four public accounting firms have indicated to us the increase could, in fact, be significantly greater – up to a multiple of the current audit fee. We think they have underestimated its impact. There will be even more substantial costs for the affected public companies. Audits of internal control over financial reporting are generally thought to result in the following benefits: improvement of public confidence in our financial reporting system and, consequently, in our capital markets, and prevention of business and financial reporting failures such as Enron and WorldCom. While we think such audits may help improve public confidence we question whether such audits will have much, if any, impact on business and financial reporting failures such as Enron and WorldCom.

Expectations Gap

In addition to the overall cost benefit disparity, we are even more concerned with the widely held misperception that audits of internal control will eliminate business and financial reporting failures. We fear this "expectations gap" may serve to further undermine our markets if, or when, we experience the next serious business and financial reporting failure. At least in part, this "expectations gap" has, in fact, resulted from unrealistic expectations created by some of the recent rule-making initiatives. For example, the chief executive and chief financial officers of registrant

companies must file quarterly and annual "certifications" under Section 302 of Sarbanes-Oxley. These "certifications" address: accuracy of financial statements filed with the SEC, effectiveness of disclosure controls and procedures, and changes in internal controls that could materially affect registrant financial statements.

We strongly disagree with this nomenclature. Terms such as "certification" and "ensure" imply a much higher level of assurance than can reasonably be applied to financial information and internal controls. As previously mentioned, internal controls provide reasonable, but not absolute, assurance that financial statements are not materially misstated. Financial statements present fairly a company's financial position, results of operations and cash flows in accordance with generally accepted accounting principles. These are not absolute standards. "Management certification" is far too strong a characterization. "Management representation" would more appropriately convey the degree of assurance investors should attach to such statements. It is precisely this type of rule making that widens, rather than narrows, the "expectations gap."

Evaluating the Effectiveness of the Audit Committee's Oversight of The Company's External Financial Reporting and Internal Control Over Financial Reporting

We think requiring the auditor to evaluate the effectiveness of the company's audit committee creates an inherent serious conflict of interests in view of the committee's responsibility for appointing the auditor. Additionally, it may also serve to further undermine effective relationships among the company's board of directors, audit committee, management and external auditor. We think it is appropriate for the auditor to consider performance of the audit committee in evaluating the company's control environment. However, we do not think it would be practical to require an evaluation of audit committee effectiveness in view of the inherent conflict.

Circumstances Regarded as at Least a Significant Deficiency and Strong Indicator of a Material Weakness

We do not think the following circumstances warrant the presumption it "should be regarded as at least a significant deficiency and is a strong indicator a material weakness exists" without further evaluation of all the relevant facts and circumstances:

- Restatement of previously issued financial statements.
- Ineffective oversight by the company's audit committee.
- Ineffective regulatory compliance.
- Fraud of any magnitude on the part of senior management.
- Significant deficiencies, which remain uncorrected.

We cannot presume any of the foregoing situations constitute either a significant deficiency or material weakness without further consideration of the specific facts and circumstances. For example, many restatements result from evolving developments in financial reporting and, in some cases, changes to prevalent practice mandated by the SEC or other rule-makers. As indicated previously, we do not think auditor evaluation of audit committee effectiveness is appropriate given the inherent conflict of interests. Assessment of the significance of deficiencies in regulatory compliance and management fraud would require some consideration of the significance of the amounts involved and, with respect to management fraud, the position and authority of personnel. Finally, there may be very good reasons certain significant deficiencies are not corrected, particularly given the definitional issues discussed above regarding significant deficiencies.

We also think audit adjustments identified by the company's auditors may not necessarily be indicative of a material weakness or even a significant deficiency. Audit adjustments of relatively subjective estimates, for example, may more nearly represent a difference in judgment than a deficiency in the estimation process itself.

In addition, we do not think it reasonable to define deficiencies as "at least a significant deficiency" without regard to the significance of the amounts involved and all other pertinent facts and circumstances. More specifically, the categorical classification of the following deficiencies as "at least a significant deficiency" does not seem appropriate:

- Controls over the selection and application of accounting principles.
- Antifraud programs and controls.
- Controls over non-routine and non-systematic transactions.
- Controls over the period-end financial reporting process.

Furthermore, changes in control procedures and practices, such as antifraud programs, controls and procedures, are not necessarily indicative of deficiencies. Controls and procedures evolve over time and adapt to business innovation, technology and consequent changes in overall business practices. Moreover, changes in accounting practices are likewise not necessarily indicative of deficiencies as prevalent practices evolve over time with changes and improvements in prevalent financial reporting and accounting practices.

Auditor Responsibility for Reporting all Deficiencies to Management

The requirement for auditors to report ALL deficiencies to management is, without any possible doubt, much too broad. Presumably this would require reporting deficiencies in internal control over financial reporting - even where effective mitigating controls exist. Perhaps consideration should be given to hierarchy of scale, which is common in large, multinational companies, where certain deficiencies are discussed and resolved at the local level and are not escalated further.

Auditor Responsibility for Quarterly Disclosures

The scope of the auditor's responsibility for quarterly disclosures about internal control is ambiguous and there is no requirement under the Sarbanes-Oxley Act for the auditor to perform work relative to the company's quarterly disclosures. Furthermore, the differing levels of auditor responsibility regarding the management's quarterly disclosures versus management's annual assessment may create more investor confusion and further widen the "expectations gap".

Areas for Additional Guidance

We suggest the Board consider providing additional guidance in the following areas:

- Expand on guidance regarding appropriate framework for IT controls:
    - Incorporate reference to "Control Objectives for Information and Related Technology" (COBIT), published by the IT Governance Institute.
    - Reference recent Discussion Document published by the IT Governance Institute and ISACA regarding applicable IT control objectives and controls ("IT Control Objectives for Sarbanes-Oxley: The Importance of IT in the Design, Implementation and Sustainability of Internal Controls Over Disclosure and Financial Reporting").
- Identify independence and internal control-related services, which would compromise auditor independence.
- Clarify independence issues where service provider audits are performed by the company's external auditor.
- Identify time frame necessary to establish newly instituted controls are effective.

We thank you for the opportunity to express our views in this letter. If you have any questions or would like to further discuss our comments, please feel free to contact Dennis Dooley at (248) 372-3306 or me at (310) 615-1728.

Sincerely,

Leon J. Level
Chief Financial Officer

cc:

Mr. William J. McDonough, Chairman
Ms. Kayla J. Gillan, Board Member of the PCAOB
Mr. Daniel L. Goelzer, Board Member of the PCAOB
Mr. Bill Gradison. Board Member of the PCAOB
Mr. Charles D. Niemeier, Board Member of the PCAOB
Dr. Douglas R. Carmichael, PhD., CPA,CFA.

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