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UPDATE 2-US audit watchdog proposes less process auditing

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(Recasts with comments from SEC's Cox, Chamber of Commerce)

By Kevin Drawbaugh

WASHINGTON, Dec 19 (Reuters) - The processes used by companies to keep their books in order would get less scrutiny from outside auditors under a proposal given preliminary support by U.S. auditing regulators on Tuesday.

In a 5-0 vote, the Public Company Accounting Oversight Board (PCAOB) proposed scaling back outside audits of internal controls, marking a win for corporate America in a struggle over 2002's Sarbanes-Oxley law.

The post-Enron law -- enacted amid a wave of corporate book-cooking scandals a few years ago -- is under attack from business lobbyists, with their main target in recent months being internal control audits mandated by Section 404.

Some investor advocates defend Section 404 as vital to protecting shareholders from future Enron-type scandals.

But ever since Sarbanes-Oxley took effect, a large number of companies have complained that the Section 404 control audits that it mandated are too costly.

A strong anti-404 push has gained ground recently. Last week the Securities and Exchange Commission moved toward easing its guidance for how companies must comply.

At a public meeting, the PCAOB -- which is supervised by the SEC -- followed along, proposing a standard that would tell auditors to focus on only the riskiest internal controls, resulting in less testing of controls overall.

The proposed PCAOB standard would also drop a required evaluation by the outside auditor of management's process for assessing controls, urge more reliance on past audits, and allow scaled-down audits for small companies.

TROUBLED BY COSTS

The PCAOB also voted to propose a related standard to let outside auditors use the work of others, such as internal auditors, in reviewing controls and financial statements.

"We remain troubled by the issue of cost and overall burden.... Substantial cost savings can be achieved while preserving the benefits," PCAOB Chairman Mark Olson said.

The new standard, if formally adopted, would give auditors "flexibility to reduce testing in some areas," PCAOB Chief Auditor Tom Ray said in a briefing with reporters.

PCAOB member Kayla Gillan said the standard "does not diminish or water down" the focus on internal controls.

Final action on the standard is months away. It will undergo 70 days of public comment before another PCAOB

vote. If adopted, it would then have to go to the SEC for review.

SEC Chairman Christopher Cox said in a statement that the PCAOB proposal was "an exceptionally positive step for both investors and for America's capital markets."

The U.S. Chamber of Commerce, the nation's largest business lobbying group, also praised the PCAOB's decision.

During the Enron-era scandals, internal controls -- or how corporations keep their books in order -- were considered a distressingly common corporate weakness that needed fixing.

Congress attempted to do this in Section 404, which required companies to disclose more about their controls and required companies' outside auditors to review those controls and make public their assessments of them.

As applied by major auditors -- principally Big Four firms PricewaterhouseCoopers [PWC.UL], KPMG [KPMG.UL], Deloitte & Touche [DLTE.UL] and Ernst & Young [ERNY.UL] -- Section 404 resulted in exhaustive audits and high audit fees.

The PCAOB's proposal would "repeal the unduly expensive and inefficient auditing standard under Section 404," Cox said.

The PCAOB itself, created by the Sarbanes-Oxley law, will face a challenge on Thursday from conservative policy activists who have sued the board, questioning its right to exist.

Attorneys for both sides are scheduled to make oral arguments in federal court.

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