



## COSO Chairman

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## Board Members:

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**December 15, 2007**

Public Company Auditing Oversight Board  
166 K Street, NW  
Washington, DC 20006

Re: Preliminary Staff Views – October 17, 2007

We applaud the PCAOB in bring forth the guidance to assist auditors in audits of smaller public companies. We appreciate the references to the COSO guidance developed in 2006 which is a principles-based approach to implementing internal control over financial reporting in smaller public companies.

The preliminary views, as they relate to internal control over financial reporting are consistent with the COSO recommendations for good internal control. However, we noted one area that we would like to bring to your attention. That area deals with audit committees and boards of directors. During the development of the *COSO Internal Control over Financial Reporting – Guidance for Smaller Public Companies* (referred to hereinafter as COSO 2006 Guidance), we had extensive discussion of the nature of boards in smaller public companies and the occasional difficulty some companies might have in developing fully functional audit committees (because of size, expertise, resources, and so forth). Thus, we recognized, as your guidance does, that there may be occasions that the full board will fulfill the role that is traditionally performed by an audit committee. You recognize this on p. 12 of the preliminary views where footnote 2 states that “If no audit committee exists, all references to the audit committee in this publication apply to the entire Board of Directors of the company.” We are concerned that some people may misinterpret this footnote to assume that any board can fulfill such activities – even if that board is composed entirely of internal management.

Principle 2 of the COSO 2006 Guidance deals with the oversight responsibilities of the board. The guidance further states:

“Corporate governance has evolved such that audit committees perform most of the activities noted below. Increasingly, boards of smaller companies have audit committees of independent directors. When a board chooses not to have an audit committee, the full

board performing the activities described should have a sufficient number of independent members.” (p.23)

The COSO 2006 Guidance also identifies a primary attribute as:

*“Operates Independently* – The board has a critical mass of members who are independent directors.” (p. 23)

As with the other parts of the document, we view the intent of footnote 2 in your “Preliminary Views” was to be consistent with the COSO 2006 guidance. Therefore we would suggest a minor modification to your footnote that would incorporate the concept of a critical mass of independent directors. One suggestion is that the footnote be amended to refer to the COSO guidance and read as follows:

“If no audit committee exists, all references to the audit committee in this publication apply to the entire Board of Directors of the company. See also COSO’s 2006 *Guidance for Smaller Public Companies*, Principle 2, which states: “Corporate governance has evolved such that audit committees perform most of the activities noted below. Increasingly, boards of smaller companies have audit committees of independent directors. When a board chooses not to have an audit committee, the full board performing the activities described should have a sufficient number of independent members.”

We appreciate your efforts in developing this guidance. Please let us know if you have any questions.

On Behalf of COSO Board

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