

Via e-mail: comments@pcaobus.org

November 21, 2003

Public Company Accounting Oversight Board
Office of the Secretary
1666 K Street, NW
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

Thank you for the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB) proposed auditing standard relating to audits of internal control over financial reporting (the Proposal). Included herein are responses to the specific questions. However, we have also included several general comments that we believe warrant the Board's attention.

Section 404 of Sarbanes-Oxley (the Act) specifically requires the independent accountant to attest and report on management's evaluation of internal control and procedures for financial reporting. Financial institutions with assets greater than \$500 million are already required to obtain an independent auditor attestation on management's assessment of internal controls over financial reporting. The commentary accompanying your Proposal notes that "the Federal Bank regulator representative present at the Board's Roundtable indicated that experience with the Federal Deposit Insurance Corporation Improvement Act of 1991, which requires internal control reporting similar to Section 404 of the Act, revealed instances where the auditor used the work of internal auditors to an inappropriately high degree, where the auditor himself or herself did not perform sufficient work to provide a reasonable basis of his or her opinion". We believe this statement to be reflective of the execution or competence of specific individuals and not necessarily an indictment of existing attestation standards or existing management processes in place at all financial institutions.

We are particularly concerned that financial institutions, which have developed comprehensive processes to evaluate internal controls over financial reporting will be subject to significant additional expense without corresponding benefit.

We believe that the Proposal goes far beyond the requirements of the law by requiring an audit of internal control over financial reporting, rather than an attestation regarding management's assessment of those controls. In that regard, given the breadth and complexity of the work required to perform an audit of internal controls in conjunction with the considerable differences in the manner in which internal controls are established and implemented at various organizations. We believe that independent accountants be afforded considerable flexibility in using their professional judgment to determine both the scope of their work and the extent to which they can rely on the work of others. We believe this to be particularly appropriate given the fact the independent accountant will also be required to issue an opinion on the financial statements.

We believe the Board should follow the approach set forth in statement of Auditing Standard No. 65, which allows the auditor to assess the competency and objectivity of the internal audit function and make judgments about the extent to which the work of internal audit can be ruled upon.

We also believe that the Proposal has an inherent conflict with one of the basic premises of the Act, which is to ensure auditor independence. The Act specifically prohibits the independent accountant from a range of non-audit services including internal audit co-sourcing. However, the Proposal as currently crafted has the potential to significantly increase work required by the independent accountant that could be defined as internal audit in nature. Given the significant variance in the cost structures of an independent accounting firm and an internal audit division, the Proposal could result in significant cost increases with far less actual internal control coverage.

The Act requires that audit committees be directly responsible for the appointment, compensation, and oversight of the independent accountant. Additionally, New York Stock Exchange (NYSE) Rules require audit committees to perform specific functions concerning supervision of the independent accountant's work. The Proposal requires that the independent accountant is to perform an assessment of the effectiveness of the audit committee. Accordingly, we believe the Proposal creates an inherent conflict of interest and potentially violates established independence rules. We believe that corporate governance rules established by the NYSE provide adequate requirements for review of the audit committee performance.

We recognize that the Board faces a significant and difficult challenge in developing a standard that effectively addresses concerns surrounding

the reliability of financial information without creating unworkable or impractical implementation problems. We believe your consideration of our comments, in conjunction with leveraging existing standards already in place at financial institutions, would provide a standard that fulfills the requirements and intentions of the Act as well as provide flexibility to covered companies.

Selected Questions

(Numbers refer to question numbers in the Proposed Standard.)

1. No, The Act requires the PCAOB to establish standards governing the independent accountants attestation on management's assessment of the effectiveness of internal control over financial reporting. We believe the intent of the Act is to ensure that management understands its responsibility for the internal control environment and establishes sufficient processes to determine that the internal control environment is operating effectively. Correspondingly, we believe the scope of independent accountant attestation should be to determine that management has established appropriate processes and evaluation techniques. In our opinion, requiring an audit of internal control over financial reporting goes well beyond the requirements of the Act and has the potential to put the independent accountant in the roll of management as primarily responsible for the adequacy of internal controls.
2. Yes. We believe the Proposal has basically redefined what constitutes the procedures necessary to provide an opinion on the financial statements by stating that the auditor cannot audit internal control over financial reporting without also auditing the financial statements.
3. Yes. However, in reality it's still not practical to have a separate firm report on internal controls. The work they do would be duplicative.
4. Yes. Appendix E gives appropriate consideration to how internal control is implemented in, and how the audit of internal control over financial reporting should be conducted at, small and medium-sized organizations.
5. No. The Board should not establish further rules governing audit personnel's academic background or experience in auditing financial statements. There are sufficient rules governing competency of staff in the professional standards. These standards merely need to be enforced.

6. Yes. It's obvious that the auditor would need to evaluate management's assessment, and to do so they must have considerable understanding of the control environment. This was the case prior to the proposed standard and is even more apparent now. However, we believe that the auditor should be afforded considerable judgment in determining the reliance that can be placed on the work of others.
7. Yes. The criteria should provide consistency between how management documents and the documentation auditors expect to review.
8. No. Inadequate or lack of documentation should not be considered an internal control deficiency. The key is whether the controls are functioning and effective. The auditor should evaluate whether the controls are adequate. In order to do this evaluation they may need to prepare their own documentation or utilize documentation by management. There are situations in which simple processes could be determined to be well controlled without documentation.
9. Yes. Walkthroughs allow the auditor to observe the process, and confirm their understanding.
10. No. The auditor should be allowed to use walkthrough procedures performed by internal auditors. External auditors should be able, in most cases, to test and rely on the work of internal audit just as they do in the audit of financial statements.
11. No. A control should be tested initially and then only changes to the control should be required to be tested in subsequent periods. It would be inefficient to test the same control each year. A rotational testing, combined with benchmarking, should be sufficient to conclude on management's assertions.
12. External auditors should be able, in most cases, to rely on the work of internal audit. External auditors should be permitted to rely on the judgment of internal audit for testing of processes after performing an evaluation and testing of internal audit work in accordance with existing guidelines. The Proposal states that many functions must be performed and tested by the external audit firm. Many of these functions would require duplicative work by the external auditor that is excessive and unnecessary.
13. No. The audit should be risk based and not static based on three categories of controls. As stated in the response to question

- Number 12, external auditors should be permitted to evaluate and rely on the work of internal audit.
14. No. As written, the Proposal may cause a reduction in the coverage by internal audit. If certain procedures are required to be performed by external auditor, management may reduce internal audit coverage in an effort to avoid duplication. Given existing cost structures as well as the specific expertise and institutional knowledge that qualified internal auditors provide, this could result in less audit coverage at a significantly increased cost
 15. No. The Proposal does not give enough flexibility. The flexibility in determining the extent of reproducing the work of others should not be based on the three categories of control but be risk based with the use of sampling. Existing professional standards provide sufficient guidance on evaluating and relying on internal audit.
 16. No. The Proposal is unclear and limits overall judgment. The Proposal sets requirements that are too prescriptive and limits management and internal audits judgment. Management establishes all major processes. Companies document the flow of processes. Significant work, concern, and time go into the development and documentation of processes. External auditors should be permitted to establish a basis and rely on the judgment of management and internal audit for establishment of processes and internal testing thereof.
 17. No. Proposal uses the term “significant” too narrowly. The Proposal refers to “significant” as “more than remote” or “likelihood of occurrence” to refer to areas of deficiencies. This level is too low of threshold for the use of “significant” and seems to be at a lower level than current auditing standards.
 18. Yes. The examples in Appendix D are helpful.
 19. Yes. The auditor would need to evaluate the severity of all identified internal control deficiencies to determine if they are significant deficiencies, a material weakness or just a deficiency.
 20. No. Clearly material weakness and significant deficiencies should be reported to management in writing. However, for lesser weaknesses, we believe the method of reporting should be left to the professional judgment of the auditor.
 21. Yes. The matters are appropriately classified.

22. No. FFIEC and Stock Exchange rules provide for audit committee review. The FFIEC established expectations for effective audit committees. Further, the NYSE and NASDAQ established new corporate governance rules that include criteria for effective audit committees. The COSO framework also provides for assessment of internal controls and the “tone at the top”.
23. No. Proposal violates the SEC auditor independence rules. The Proposal requires that the public accounting firm is to perform an assessment of the effectiveness of the audit committee. The Sarbanes-Oxley Act requires that public accounting firms report to the audit committee. Separately, the public accounting firm is hired/chosen by the audit committee and the company pays the accounting firm. External accounting firms would not be in the position to be adequately independent to opine on the effectiveness of the audit committee.
24. No. The auditor should be required to issue an adverse report, if they conclude that there is ineffective audit committee oversight.
25. No. A single material weakness is rarely the cause, but rather the combination of several material weaknesses. Flexibility should be given as to the nature of the weakness and as to whether other mitigating controls exist.
26. No. Per the Proposal, either a material weakness exists or it does not.
27. No. An audit opinion shall not be required, only attestation to managements assertion of whether internal controls are effective. Sarbanes-Oxley directs the PCAOB to establish standards governing the independent auditor’s attestation and reporting on management’s assessment of the effectiveness of internal control over financial reporting.
28. No. The independence rules should establish the nature of non-audit services that can be provided.
29. Yes. Consulting services as it relates to internal controls and internal audit services.
30. Yes. Requiring the auditor to provide an attestation on management’s assessment of internal controls over financial

reporting is sufficient. Additionally, we believe the quarterly requirements (excluding the fourth quarter) are appropriate.

31. No. We do not believe that requiring a different level of responsibility, as it relates to changes in internal control made in the fourth quarter, is appropriate. If management identifies and corrects a material weakness, and it is reported to the audit committee with no subsequent year-end financial statement impact, we do not believe disclosure in the annual report is necessary.

Thank you for the opportunity to comment.

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