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

Via e-mail: comments@pcaobus.org

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*

Dear Board Members and Staff,

We appreciate the opportunity to comment and commend the Public Company Accounting Oversight Board's ("Board" or "PCAOB") efforts on the proposed auditing standard, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements*. Our concerns with respect to the proposal are expressed below and in Appendix A, which contains our responses to the questions put forward by the Board. Additional paragraph-level comments are presented in Appendix B. Other recommendations are included in Appendix C.

Management's Assessment of Effectiveness

Management is required to present a written assessment of the effectiveness of internal control over financial reporting. The auditor's attestation of management's assessment is referred to as the audit of internal control over financial reporting ("audit of internal control"). There is a clear distinction, however, between management's **assessment** and their **assertion** and the auditor's responsibilities with respect to such. We believe that an audit of internal control is an attestation of management's **assertion**, rather than their **assessment**, of internal control effectiveness.

Management makes an assertion as to whether internal control is effective, just as management makes assertions that are embodied in the financial statements. Management's assessment is their process of determining whether internal control over financial reporting is effective. Accordingly, management's assessment process supports their assertion. When performing an audit of internal control over financial reporting, the auditor evaluates management's assessment process and management's assertion of effectiveness. Further, the auditor is not prohibited from opining directly on internal control over financial reporting. It is more evident that when opining directly, the auditor is opining on management's assertions regarding internal control effectiveness and not management's assessment. Accordingly, we object to the use of the term assessment to describe the auditor's attestation. Management's report should also contain their assertion regarding the effectiveness of internal control over financial reporting and not their assessment or evaluation of such effectiveness.

Safeguarding of Assets

We suggest that the Board enhance Appendix C to provide additional guidance on safeguarding controls that fall within the scope of internal control over financial reporting. In addition, as indicated in our response to question number 18, it would be very useful to provide examples that illustrate internal control deficiencies relating to safeguarding of assets that are financial reporting in nature, deficiencies that relate to the assertions about safeguarding that management is required to make under Section 404 of the Sarbanes-Oxley Act of 2002, and deficiencies in safeguarding that are not within the scope of financial reporting and Section 404 assertions.

Revisions to Existing Interim Standards

The Board appears to be using this proposed standard to revise, summarize, and/or supplement existing interim standards, including independence, fraud, the work of internal audit, the work of other auditors, analytical procedures, interim reviews, and filings under federal securities statutes. The Board has also revised the requirement related to the performance of substantive procedures on material account balances and has provided significant guidance with respect to the company's use of a service organization.

With respect to service organizations, we do not clearly understand how this relates or may even supersede existing interim standards (AU Section 324, *Service Organizations*). While summarizing some of the content in the existing standards, the proposed standard changes the content of the interim standards. For example, the proposed standard, among other things, appears to change the requirements for when a service organization is part of the company's information system (paragraph B26) and omits the fact that an auditor's report on controls placed in operation also provides evidence as to whether the controls have been placed in operation (paragraph B30).

We urge the Board not to use this proposed standard as a vehicle for revising, summarizing, and/or supplementing the interim standards. When summarizing existing literature or restating it using different words, the intent, meaning, and requirements may be inadvertently altered. Further, when revising, summarizing, and/or supplementing the interim standards, the requirements for an audit of internal control versus an audit of the financial statements may be undistinguishable. Accordingly, we suggest that the Board amend existing interim standards to reflect newly adopted requirements. We prefer that requirements and guidance relating to the same subject matter be kept intact to promote compliance with the standards, rules and regulations. The Board may choose to only include additional considerations or requirements necessary for the opinion on internal control over financial reporting in the proposed standard, while referencing the existing interim standard for the fundamental definitions, requirements, and guidance. The Board should, at a minimum, delete the requirements and guidance from the interim standards that are no longer applicable.

Authoritative Status of Appendices

The Board has indicated that the appendices carry the "same authoritative weight" as the standards. We recommend that the Board clarify whether the examples are being used to establish requirements, including whether they are setting a standard for documentation. In addition, we suggest clarifying whether the Board's statement also applies to the interim standards. The Board should perform a standard-by-standard review of the interim standards prior to adopting the "same authoritative weight" requirement for such standards.

We would be pleased to discuss any of our comments with you. If you have any questions, please contact Mr.. John L. Archambault, Managing Partner of Professional Standards, at (312) 602-8701.

Very truly yours,

John L. Archambault

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Appendix A – Responses to Questions

Questions Regarding an Integrated Audit of the Financial Statements and Internal Control Over Financial Reporting

1. **Is it appropriate to refer to the auditor's attestation of management's assessment of the effectiveness of internal control over financial reporting as the audit of internal control over financial reporting?**

   As discussed in our cover letter, we object to the use of the term "assessment" to describe the auditor's attestation. Accordingly, it is not appropriate to refer to the auditor's attestation of management's "assessment" of the effectiveness of internal control over financial reporting as an audit of internal control over financial reporting ("an audit of internal control"), but it is appropriate to refer to the auditor's attestation of management's "assertion" as to effectiveness as an audit of internal control. An "audit" is an attest engagement that is designed to provide a high level of assurance. In an audit of internal control, a high level of assurance is obtained to provide a basis for expressing an opinion on management's assertion.

   In the past, the American Institute of Certified Public Accountants used the terms "audit" and "examination" synonymously. The term audit was restricted to the audit of the financial statements, while the term examination referred to the same level of assurance given on other management assertions. Whether the auditor's attestation of management's assertion is referred to as an audit or an examination is not very important, as very few people ever grasped the distinction.

2. **Should the auditor be prohibited from performing an audit of internal control over financial reporting without also performing an audit of the financial statements?**

   An audit of internal control over financial reporting and an audit of the financial statements are two types of attest engagements that provide a high level of assurance on different subject matter. Although the auditor may gain efficiencies by performing both the audit of internal control and the audit of the financial statements, the auditor's procedures for each engagement should be sufficient to reduce attestation risk to an appropriately low level. We believe that each engagement can be performed without the performance of the other, and that it is important to preserve attestation standards that support audits of internal control as a separate service.

   An audit of internal control provides reasonable assurance about whether the company maintained, in all material respects, effective internal control over financial reporting. The identification of a material weakness or a significant deficiency, however, does not necessarily imply that a material misstatement in the financial statements exists. Nor does the lack of the identification of a material misstatement in a financial statement audit imply that internal control is effective. Accordingly, an audit of the financial statements is not necessary to opine on the effectiveness of internal control over financial reporting. Further, due to the performance of substantive procedures, an audit of internal control is not necessary to perform a financial statement audit.

   In addition, there may be situations where a separate attestation standard that supports audits of internal control, without the performance of a financial statement audit, may be necessary. For example, an auditor may be asked to opine on the effectiveness of an entity's internal control as of an interim date where an audit of the financial statements has not been performed. The auditor may also be involved in a re-audit situation, where the auditor that performed the audit of internal control is not the auditor that re-audited the financial statements. An auditor may also be asked to perform an audit of internal control for registered investment companies or issuers of asset-back securities that are not subject to the Section 404 requirements but may be subject to the PCAOB's Auditing and Related Professional Practice Standards.

Therefore, while we believe the auditor can perform an audit of internal control over financial reporting without also performing an audit of the financial statements (and vice versa), we cannot offer a specific situation where such a request would arise for companies required to include in their annual report a management report on internal control over financial reporting. For such companies, it is appropriate to require that the same auditor perform both the financial statement audit and the audit of internal control over financial reporting, as we believe this is the intent of the Act and in the public interest.

Our response to question three discusses the auditor's procedures in an audit of internal control over financial reporting when an audit of the financial statements has not been performed.

3. Rather than requiring the auditor to also complete an audit of the financial statements, would an appropriate alternative be to require the auditor to perform work with regard to the financial statements *comparable* to that required to complete the financial statement audit?

It is not an appropriate alternative to require the auditor to perform work with regard to the financial statements comparable to that required to complete the financial statement audit. As described in our response to question number two, an audit of the financial statements need not be performed in order to execute an audit of internal control. However, it is appropriate to consider the evidence obtained in a financial statement audit in light of the auditor's conclusions regarding the effectiveness of an entity's internal control over financial reporting.

Where a financial statement audit is not performed, however, certain procedures with respect to obtaining an understanding of the entity and its environment and communicating with the auditor of the financial statements may need to be more extensive. For instance, the auditor should perform sufficient procedures to ensure that they appropriately identify controls related to relevant financial statement assertions for significant accounts and disclosures in the financial statements. Where the auditor has not performed the financial statement audit, the auditor may need to perform additional inquiries and/or other procedures to enhance their understanding of such processes and controls. The auditor may also need to communicate with the current auditor as to their internal control findings, any material misstatements noted, and any disagreements with respect to such matters. Such information, however, may be obtained through discussions with management and/or those charged with governance.

Conversely, the performance of substantive procedures is not necessary for an audit of internal control over financial reporting. However, while performing an audit of internal control, the auditor may review source documents (such as sales invoices) through tests of controls.

Question Regarding the Costs and Benefits of Internal Control

4. Does the Board's proposed standard give 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 issuers?

As stated by the board in the introductory discussion to the proposed standard, "Internal control is not a "one-size-fits-all," and the nature and extent of controls that are necessary depend, to a great extent, on the size and complexity of the company." Although we concur that internal control may be implemented differently at smaller, mid-sized entities and are pleased that the proposed standard allows professional judgment in evaluating effectiveness, we have concerns with respect to the guidance provided by the Board on how internal control is implemented and on how the audit of internal control over financial reporting should be conducted at such entities.

The Board states (on page 6 of the introductory discussion to the proposed standard), "For a smaller, less complex company, the Board expects that the auditor will exercise reasonable professional judgment in determining the extent of the audit of internal control and perform only those tests that are necessary to ascertain the effectiveness of the company's internal control." We concur that an auditor should exercise professional judgment to perform only those procedures necessary. However, we believe that such judgment must be exercised on each engagement to audit internal control over financial reporting, regardless of the size and complexity of the entity. Small and medium-sized companies may have complex operations, while large, complex, multi-national companies may also have some simple operations. Accordingly, each company must establish and maintain necessary internal controls to prevent and detect misstatements on a timely basis, and the proposed standard imposes the minimum procedures that must be performed on all audits to evaluate the effectiveness of such controls.

The statement made above in conjunction with the guidance in Appendix E may be interpreted to infer that smaller, mid-sized companies can take a casual approach in implementing the necessary controls and in evaluating their effectiveness. Further, the auditor's standards for performance and evaluation appear to be lowered for such entities. The proposed standard requires the auditor to obtain sufficient competent evidence about the design and operating effectiveness of controls related to all relevant financial statement assertions for all significant accounts and disclosures in the financial statements. However, Appendix E discusses matters such as informal processes, monitoring controls performed by senior management, and the lack of documentation. This indirectly implies that there are certain internal control matters that the auditor can overlook when evaluating effectiveness for small and mid-sized companies.

In addition, Appendix E is currently being used as a supplement to the framework used by management to conduct its assessment, rather than as a guide on how the audit of internal control should be conducted for small and mid-sized companies. As the Committee of Sponsoring Organizations of the Treadway Commission's *Internal Control – Integrated Framework* already provides guidance on the application of the five internal control components to small and midsized entities, the proposed standard should not be used to modify or supplement such framework.

We recognize the PCAOB's well-intended efforts to provide guidance specifically related to smaller, mid-sized entities and to allow for professional judgment. However, due to the concerns expressed above, we believe that Appendix E should be deleted. Auditors of such entities would be able to apply the proposed standard in the absence of such guidance.

Question Regarding the Audit of Internal Control Over Financial Reporting

5. Should the Board, generally or in this proposed standard, specify the level of competence and training of the audit personnel that is necessary to perform specified auditing procedures effectively? For example, it would be inappropriate for a new, inexperienced auditor to have primary responsibility for conducting interviews of a company's senior management about possible fraud.

It is not necessary to specify the level of competence and training needed to perform a specific audit procedure, generally or in the proposed standard. The interim standards (see AU Section

210, *Technical Training and Proficiency of the Independent Auditor)* appropriately describe the auditor's training, education, experience, supervision, review, and judgment with respect to performing an audit. As discussed in the interim standards, "The auditor charged with final responsibility for the engagement must exercise a seasoned judgment in the varying degrees of his supervision and review of the work done and judgment exercised by his subordinates, who in turn must meet the responsibility attaching to the varying gradations and functions of their work."

The proposed standard requires (in paragraph 31) the auditor to have competence in the subject matter of internal control over financial reporting in order to perform an audit of such. We believe this guidance is sufficient and appropriate. However, we suggest providing a reference to AU Section 210, which governs the technical training and proficiency of the auditor.

Questions Regarding Evaluation of Management's Assessment

6. Is the scope of the audit appropriate in that it requires the auditor to both evaluate management's assessment and obtain, directly, evidence about whether internal control over financial reporting is effective?

It is appropriate to require the auditor to evaluate the process management used to support its certifications and assertion to the auditor about the effectiveness of internal control over financial reporting. Although this arrangement places the auditor in the difficult position of having to make a judgment about the adequacy of management's efforts, we believe this is appropriate. We also believe it is important for the auditor to obtain his or her own evidence in order to provide an independent and objective opinion on management's assertion.

On the other hand, it may not be appropriate to require the auditor to disclaim an opinion where management has not fulfilled their responsibilities, as described in paragraphs 19 and 20. As previously discussed, the auditor's attestation is on management's assertion of the effectiveness of internal control over financial reporting. Even though management may not have performed adequate procedures to support their assertion, the auditor may be able to perform procedures to determine whether internal control over financial reporting is effective.

7. Is it appropriate that the Board has provided criteria that auditors should use to evaluate the adequacy of management's documentation?

It is appropriate that the Board has provided criteria against which auditors can evaluate the adequacy of management's documentation to determine whether such documentation provides reasonable support for management's assessment. Not only does this criteria assist the auditor in determining whether management's documentation is adequate, it also assists management in determining the nature and extent of documentation that is necessary to support their assessment. Without such guidance, the auditor has no basis in evaluating the significance of the deficiency or the nature of the potential scope limitation.

When evaluating the adequacy of management's documentation, however, we believe that the auditor should also evaluate whether such documentation includes (a) the identification of where misstatements due to fraud or error could occur, (b) the specific controls that have been implemented to prevent or detect such misstatements, (c) the nature, timing and extent of the testing performed, and (d) the identification of the specific controls that were tested for operating effectiveness.

8. **Is it appropriate to state that inadequate documentation is an internal control deficiency, the severity of which the auditor should evaluate? Or should inadequate documentation automatically rise to the level of significant deficiency or material weakness in internal control?**

It is appropriate to allow auditor judgment in evaluating whether management's inadequate documentation represents an internal control deficiency, a significant deficiency, or a material weakness in internal control. Because documentation may take many forms, can include a variety of information, and can vary depending on the size, nature, and complexity of the company, the severity of the deficiency is a matter of professional judgment, as is the evaluation of the adequacy of management's documentation.

We recommend, however, that the Board clarify and revise the last sentence in paragraph 46, which states, "In evaluating the deficiency as to its significance, the auditor should determine whether management can demonstrate the monitoring component of internal control over financial reporting in the absence of documentation." This statement may have unintended consequences and could lead to arguments between management and the auditor as to the adequacy of management's efforts. It provides management a reason not to support their assessment through adequate documentation.

We further recommend a cross-reference to paragraph 20, which discusses the issuance of a disclaimer when management has not fulfilled its responsibilities.

Questions Regarding Obtaining an Understanding of Internal Control Over Financial Reporting

9. **Are the objectives to be achieved by performing walkthroughs sufficient to require the performance of walkthroughs?**

As stated in paragraph 79, the objectives of a walkthrough are to:

1. Confirm the auditor's understanding of the process flow of transactions.
2. Confirm the auditor's understanding of the design of controls identified for all five components of internal control over financial reporting, including those related to the prevention or detection of fraud.
3. Confirm that the auditor's understanding of the process is complete by determining whether all points in the process where misstatements related to each relevant financial statement assertion that could occur have been identified.
4. Evaluate the effectiveness of the design of controls.
5. Confirm whether controls have been placed in operation.

We believe that all of the items listed above constitute what can be achieved through the performance of a walkthrough and other audit procedures, but does not necessarily represent the objectives of a walkthrough itself. We further believe that numbers 1 and 5 above constitute the objectives of a walkthrough, but numbers 2, 3 and 4 do not.

Walkthroughs are performed to confirm or obtain an understanding of the process flow of transactions and the related controls and whether the documentation is accurate. While performing a walkthrough, the auditor can also determine whether such controls are placed in operation. Walkthroughs are not performed to evaluate the design of such controls. The auditor uses his or her professional judgment to evaluate design effectiveness based on all of the evidence obtained. Although a walkthrough may assist with obtaining information to perform such evaluation, it would rarely in itself be sufficient to conclude on design effectiveness.

Further, walkthroughs do not assist the auditor to confirm or obtain an understanding of the design of controls identified for <u>all five internal control components</u>. For example, the control environment does not relate to a specific transaction or event that can be traced through the information system. Finally, a walkthrough does not determine whether all points in the process where misstatements related to each relevant financial statement assertion that could occur have been identified.

Accordingly, we do not believe that it is necessary for the auditor to perform a walkthrough for <u>all</u> of the company's significant processes, including <u>all</u> types of transactions and events, whether they are recurring or unusual, on <u>each</u> audit of internal control over financial reporting. However, we do believe that there are certain circumstances where a walkthrough should be required to be performed by the auditor, as discussed in our response to question number 10.

We advise the Board not to overstate the benefits of a walkthrough. The "objectives" identified in the proposed standard can be achieved through the performance of other procedures, including inquiry, observation, and other tests of controls where the auditor reviews and compares supporting documents to the accounting records. We suspect such procedures are equally applicable to other processes also. So, while we agree that walkthroughs provide valuable evidence to the auditor, other procedures are sometimes available, which is why we urge that some judgment be afforded the auditor to choose the appropriate procedure to apply in the circumstances. For example, where the auditor performs tests of controls directly, he or she may not need to perform a walkthrough. However, where the auditor plans to rely on tests performed by others, the auditor may need to perform a walkthrough to obtain and/or confirm his or her understanding of the process flow of transactions.

Additionally, walkthrough procedures may differ for each audit. For example, in an initial audit, the auditor may need to perform more walkthrough procedures than in a continuing engagement. In a continuing engagement, the auditor may perform other procedures to achieve the objectives of the walkthrough and to update his or her understanding of the entity's processes and controls. In continuing engagements, the auditor may also alter the nature, timing, and extent of walkthrough procedures performed directly (or the use of walkthrough procedures performed by management and others) to introduce an element of unpredictability.

Finally, we recommend that the Board adequately define the term "significant process." We note that it always includes the period-end financial reporting process, which we agree with.

10. Is it appropriate to require that the walkthrough be performed by the auditor himself or herself, rather than allowing the auditor to use walkthrough procedures performed by management, internal auditors, or others?

Hopefully, the Board will agree with our response to question number 9. If so, we believe that it is appropriate to require the auditor to perform the walkthrough.

However, to achieve the objectives, as stated in the proposed standard, we believe the guidance provided by paragraphs 103 through 110 regarding the use of the work performed by management and others applies equally to walkthrough procedures and any other procedures performed by management and others. Accordingly, the auditor should be allowed to use his or her professional judgment in determining whether to use walkthrough procedures performed by management and others to alter the nature, timing, and extent of the tests of controls performed directly by the auditor to achieve the objectives of the walkthrough procedures. That said, however, the restrictions and limitations on the work performed by management and others should also be adhered to.

Question Regarding Testing Operating Effectiveness

11. Is it appropriate to require the auditor to obtain evidence of the effectiveness of controls for all relevant assertions for all significant accounts and disclosures every year or may the auditor use some of the audit evidence obtained in previous years to support his or her current opinion on management's assessment?

    It is appropriate to require the auditor to obtain sufficient competent evidence about the design and operating effectiveness of controls related to all relevant financial statement assertions for all significant accounts and disclosures in the financial statements. The auditor should obtain such evidence each year to support his or her opinion on management's assertion of the effectiveness of internal control over financial reporting. However, the sufficiency of the evidence obtained is a matter of professional judgment. Additionally, such evidence may differ from year to year, as the auditor alters the nature, timing, and extent of his or her procedures.

    As stated in paragraph 101, "The auditor also should vary from year to year the nature, timing, and extent of testing of controls to introduce unpredictability into the testing and respond to changes in circumstances. For example, each year the auditor might test the controls at a different interim period; increase or reduce the number and types of tests performed; or change the combination of procedures used." A particular area where testing may vary significantly is over information technology systems. As technology operates in a systematic manner, the auditor may evaluate and test general computer controls, including program changes and security access, while performing only limited procedures over the specific program controls.

    We acknowledge, however, that auditing is a continuous process. While the auditor uses his or her experience and knowledge of effectiveness from previous years to alter the nature, timing and extent of test of controls, he or she does not necessarily rely on the audit evidence obtained from such prior periods as the sole evidence for the current year's opinion. Further, the auditor may be placed in a unique situation where the period between opinions is less than a year. For example, the auditor may be asked to provide an opinion on the effectiveness of internal control over financial reporting as of an interim date or the company may decide to change its year-end for reporting purposes. We view such circumstances as tests performed at an interim date, where the opinion on the previous period constitutes the interim testing date. Accordingly, the auditor determines what additional evidence to obtain concerning the design and operation of the controls for the remaining period and considers significant changes in controls from the "interim" date to the "as-of" date. The auditor also considers controls that may only operate during or apply to the interim or annual periods. Where a change in the company's year-end occurs, the auditor should only be required to perform an audit of internal control when audited financial statements are required to be presented.

Questions Regarding Using the Work of Management and Others

12. To what extent should the auditor be permitted or required to use the work of management and others?

    As the auditor is ultimately responsible for his or her opinion, he or she should be allowed to apply professional judgment in determining whether to use the work of management and others to alter the nature, timing and extent of his or her procedures to obtain sufficient competent evidence to render the report. The auditor should never be "required" to use the work of management and others, as the independence and objectivity of the individuals that performed such work may have been impaired. Additionally, such individuals may not be deemed competent with respect to internal control.

Our responses to questions 13 through 16 provide additional comments on the extent the auditor should be permitted to use the work of management and others.

13. **Are the three categories of controls and the extent to which the auditor may rely on the work of others appropriately defined?**

The three categories of controls and the extent to which the auditor may rely on the work performed by management and others need some clarification. We believe that it is appropriate to prohibit the use of the work performed by management and others when evaluating controls that are part of the control environment, controls over the period-end financial reporting process, and controls that have a pervasive effect on the financial statements, due to the extensive judgment involved with such evaluation and the impact on the nature, timing and extent of the auditor's procedures. It also is appropriate to limit the use of the work of management and others in the areas addressed by paragraph 105. Such matters also involve a significant amount of judgment, but do not ordinarily have a pervasive effect on the auditor's procedures.

With respect to the third category, controls over routine processing of significant accounts and disclosures, we suggest that the Board clarify the phrase "without specific limitation." As written, it may be misinterpreted to mean that the auditor does not have any responsibilities and can rely on the work of others without performing any additional procedures. Although the auditor can use the results of tests performed by management and others, we believe that the auditor must still reperform some of the tests performed by others and use such tests to alter the nature, timing and extent of procedures he or she performs directly. However, reperforming more of the procedures performed by management and others may significantly reduce such direct procedures.

In regards to the first category where the use of the work performed by management and others is prohibited, we recommend that the Board view information technology general controls as those where the auditor's use of the work of management and others is limited. Such controls do not ordinarily involve extensive judgment.

14. **Does the proposed standard give appropriate recognition to the work of internal auditors? If not, does the proposed standard place too much emphasis and preference on the work of internal auditors or not enough?**

The proposed standard gives appropriate and adequate recognition to the work of internal auditors. It is also consistent with existing interim standards (AU Section 322, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*) with respect to evaluating internal audit's competence and objectivity in determining how internal audit's work may affect the audit of internal control over financial reporting. Such existing literature provides guidance to the auditor on evaluating internal audit's competence and objectivity and in evaluating the relevancy of their work. As such, we believe that it would be appropriate and necessary to include a reference to AU Section 322 within paragraph 108, even though the proposed standard provides a reference to such existing literature in Appendix B.

The proposed standard should not, however, add additional emphasis on the use of internal audit's work. Although the auditor may be able to use their work to a greater extent than the work performed by other personnel, internal audit is a part of the company's monitoring component of internal control. Accordingly, to place more emphasis on the use of internal audit's work may inappropriately reduce the work directly performed by the auditor.

15. **Is the flexibility in determining the extent of reperformance of the work of others appropriate, or should the auditor be specifically required to reperform a certain level of work (for example, reperform tests of all significant accounts or reperform every test performed by others that the auditor intends to use)?**

The auditor uses the work performed by management and others to alter the nature, timing and extent of his or her procedures. When using the work of management and others, the auditor should perform tests to evaluate the quality and effectiveness of the work performed. The tests performed by the auditor to make this evaluation depend on the extent of the effect of the work of management and others on the procedures performed directly by the auditor. When performing such tests, the auditor may either (a) reperform some of the work performed by management or others, or (b) examine the work performed, perform similar tests, and compare such tests to the results of the work performed by management and others.

The combination of the procedures performed to test the work performed by management and others and the tests performed directly by the auditor are a matter of professional judgment and together should provide sufficient competent evidence to support the auditor's opinion. Accordingly, it is appropriate to allow flexibility in determining both the extent of reperformance of the work of management and others and the nature, timing and extent of procedures performed directly by the auditor. The proposed standard should not mandate that the auditor reperform a certain level of work, including reperforming tests of all significant accounts or reperforming every test performed by others that the auditor intends to use.

16. **Is the requirement for the auditor to obtain the principle evidence, on an overall basis, through his or her own work the appropriate benchmark for the amount of work that is required to be performed by the auditor?**

As stated previously, the auditor is ultimately responsible for the opinion expressed. As such, it would be inappropriate for the auditor to obtain most of his or her evidence by using the work performed by management and others. On an overall basis, the auditor should perform enough procedures directly to be able to make his or her own conclusions. That said, however, the benchmark for the amount of work that is required to be performed directly by the auditor is a matter of professional judgment.

We believe that the Board intends the principal evidence requirement to apply on an overall basis, rather than on a relevant assertion or significant account basis. Accordingly, we suggest that the Board clarify its intents in the proposed standard.

Questions Regarding Evaluating Results

17. **Will the definitions in the proposed standard of significant deficiency and material weakness provide for increased consistency in the evaluation of deficiencies? How can the definitions be improved?**

We acknowledge the Board's efforts to clarify and narrow the definitions of a significant deficiency and a material weakness, to provide detailed examples on the application of such definitions, and to list the matters that are strong indicators that a material weakness exists. Altogether, this guidance should promote consistency in evaluating whether an internal control deficiency is a significant deficiency or a material weakness. Nevertheless, such evaluations involve extensive judgment, and each individual may conclude differently as to the severity of a deficiency.

With respect to the definitions of a significant deficiency and a material weakness, however, the discussion of "likelihood" should be enhanced and clarified. The proposed discussion of likelihood could be read to allow a conclusion that a deficiency is not a material weakness because it has never been a problem in the past. For instance, management can argue that there is a "remote likelihood" that a material misstatement will not be prevented or detected in the future because a material misstatement as it relates to a particular deficiency has never occurred. As such, language should be added to state that the absence of a past material error in financial reporting due to a deficiency does not mean that likelihood is low enough to keep a deficiency from being a material weakness. The definition of material weakness is focused on what could happen and is not limited to what has happened.

18. Do the examples in Appendix D of how to apply these definitions in various scenarios provide helpful guidance? Are there other specific examples that commenters could suggest that would provide further interpretive help?

As stated in our response to question number 17 above, the examples in Appendix D are useful and should assist in promoting the consistency with which internal control deficiencies are evaluated. It would be helpful, however, if one or more examples were added dealing with deficiencies relating to information technology systems or deficiencies dealing with controls over operations or compliance with laws and regulations that could materially affect financial reporting. Also, with respect to the safeguarding of assets, it would be very useful to have examples that illustrate deficiencies that are financial reporting in nature, deficiencies that relate to the assertions about safeguarding that management is required to make under Section 404, and deficiencies in safeguarding that are not within the scope of financial reporting and Section 404 assertions.

19. Is it necessary for the auditor to evaluate the severity of all identified internal control deficiencies?

The auditor's objective in an audit of internal control over financial reporting is to express an opinion on management's "assessment" of effectiveness. Where significant deficiencies, either individually or in the aggregate, constitute a material weakness in internal control, management is precluded from concluding that internal control over financial reporting is effective and the auditor must express an adverse opinion. Consequently, in order for the auditor to achieve his or her objectives, he or she should be required to evaluate the severity of all identified internal control deficiencies. Otherwise, the auditor may inappropriately conclude that internal control over financial reporting is effective.

20. Is it appropriate to require the auditor to communicate all internal control deficiencies (not just material weaknesses and significant deficiencies) to management in writing?

We believe that the auditor should communicate all identified significant deficiencies and material weakness in writing. We do not believe it is appropriate to require the auditor to communicate in writing internal control deficiencies that are below the level of a significant deficiency. Any oral or written communications of such matters should be made at the discretion of the auditor. For example, the auditor may choose to communicate deficiencies that management may not be aware of. As with the reporting of misstatements that come to the auditor's attention during an audit of financial statement, there is no need to require the reporting of every minor internal control deficiency that comes to the auditor's attention. However, the auditor may report all deficiencies noted if requested to do so by management or the audit committee.

21. **Are the matters that the Board has classified as strong indicators that a material weakness in internal control exists appropriately classified as such?**

The matters that the Board has classified as strong indicators that a material weakness exists are appropriately classified as such. These matters clearly fall within the definition of a significant deficiency, where there is more than a remote likelihood that a misstatement that is more than inconsequential in amount will not be prevented or detected. Such misstatements may be material to the financial statements and therefore, these matters could also constitute a material weakness.

There may be circumstances where the auditor identifies a material weakness in internal control over financial reporting in the current period that was not initially identified by the company's internal control evaluation and testing process. We believe that this is, at a minimum, a significant deficiency and also a strong indicator that a material weakness exists, even if management subsequently corrects the weakness. As such, we suggest that the Board add this matter to paragraph 126 as a strong indicator of a material weakness.

22. **Is it appropriate to require the auditors to evaluate the effectiveness of the audit committee's oversight of the company's external financial reporting and internal control over financial reporting?**

The proposed standard states, "The company's audit committee plays an important role within the control environment and monitoring components of internal control over financial reporting." We agree with this statement. Thus, the audit committee falls within the bounds of internal control over financial reporting, and the auditor has a responsibility to evaluate the effectiveness of the audit committee's oversight. Therefore, it is appropriate to require the auditor to evaluate the effectiveness of the audit committee's oversight of the company's external financial reporting and internal control over financial reporting as a component of internal control, but not separate from its effectiveness as it relates to the overall internal control. There are certain factors that the Board proposes to require the auditor to evaluate for which the auditor does not possess the appropriate qualifications. Such factors may not be necessary for the auditor's evaluation of the company's internal control over financial reporting.

For example, we believe that the auditor's training and experience provide a basis for evaluating the clarity with which the audit committee's responsibilities are articulated and understood by the audit committee and management and the audit committee's involvement and interaction with the external and internal auditor. However, such training and experience is insufficient to evaluate the audit committee's independence and their compliance with applicable listing standards. We believe such matters involve legal determinations that are beyond the auditor's professional competence and are not necessary to evaluate the company's internal control over financial reporting.

In the context of an audit of internal control over financial reporting, we also question the emphasis placed on the evaluation of the effectiveness of the audit committee's oversight. Effective oversight does not necessarily imply that internal control over financial reporting is effective. We believe that the audit committee's oversight is one element of the control environment (a very important one) and monitoring components of the company's internal control. Accordingly, the standard should indicate that as with any other control where a deficiency exists, the auditor evaluates the severity of the deficiency and the impact on the conclusions reached.

23. **Will auditors be able to effectively carry out their responsibility to evaluate the effectiveness of the audit committee's oversight?**

As auditors, we generally are not privy to the entire conduct of the audit committee. Further, the evaluation of the effectiveness of the audit committee's capabilities, competence, and oversight processes requires extensive judgment on the part of the auditor and, as described in our response to question number 22, certain matters related to those considerations are beyond the realm of the auditor's expertise and also may not be relevant to the auditor's consideration of the effectiveness of the company's internal control over financial reporting.

The auditor should, however, be able to effectively carry out his or her responsibility to evaluate the effectiveness of the audit committee's oversight as it relates to the evaluation of the company's internal control over financial reporting, even though the auditor may not be able to separately evaluate the effectiveness of their oversight as a whole. The auditor evaluates the effectiveness of the audit committee's oversight primarily through the appropriate use of inquiry and observation techniques focused on the audit committee's involvement with financial reporting matters. For example, the auditor focuses on metrics such as how often the audit committee meets, the audit committee's expectations, and their involvement with the risk management process, rather than evaluating their independence and compliance with external requirements.

24. **If the auditor concludes that ineffective audit committee oversight is a material weakness, rather than require the auditor to issue an adverse opinion with regard to the effectiveness of the internal control over financial reporting, should the standard require the auditor to withdraw from the audit engagement?**

The auditor should not be required to withdraw from the audit engagement in response to any identified material weakness. The presence of a material weakness, including a material weakness where the audit committee's oversight is ineffective, does not necessarily impose a limitation on the scope of the engagement. Accordingly, whether to withdraw should remain a judgment made by the auditor. Further, it would not be in the public interest to require the auditor to withdraw from the engagement due to ineffective audit committee oversight.

Questions Regarding Forming an Opinion and Reporting

25. **Is it appropriate that the existence of a material weakness would require the auditor to express an adverse conclusion about the effectiveness of the company's internal control over financial reporting, consistent with the required reporting model for management?**

When one or more material weaknesses in internal control over financial reporting exist, management is not permitted to conclude that internal control over financial reporting is effective. In such circumstances, we concur with the Board's conclusions that (a) management must report that internal control is not effective, (b) the auditor's reporting model must be consistent with managements reporting model, and (c) the issuance of a qualified "except for" conclusion by management or the auditor is not acceptable. As such, it is appropriate that the existence of a material weakness would require the auditor to express an adverse opinion about the effectiveness of the company's internal control over financial reporting.

26. **Are there circumstances where a qualified "except for" conclusion would be appropriate?**

We do not believe there are any circumstances where a qualified "except for" opinion would be appropriate. This would require the auditor to evaluate the severity of a material weakness, in essence creating another category of deficiencies.

27. Do you agree with the position that when the auditor issues a non-standard opinion, such as an adverse opinion, that the auditor's opinion should speak directly to the effectiveness of the internal control over financial reporting rather than to whether management's assessment is fairly stated?

With the public interest in mind, we agree with the Board's position to require the auditor to opine directly on internal control effectiveness when a non-standard report is to be issued. Although both opinions would be appropriate, we believe that this approach will eliminate potential confusion relating to the auditor's opinion on the effectiveness of internal control over financial reporting.

We have concerns, however, with respect to the overall reporting model, specifically relating to the identification of the financial statements to which the opinion applies. The introductory paragraph of the independent auditor's report states the following:

> "We have audited management's assessment, included in the accompanying [*title of management's report*], that W Company maintained effective internal control over financial reporting as of December 31, 20X3, based on [*Identify criteria, for example "criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organization of the Treadway Commission (COSO)."*]. W company's management is responsible for its assessment about the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment based on our audit."

From a user perspective, we suggest that the scope of the term "financial reporting" be clearly delineated in management's assertion and the auditor's report. We believe that this generic term could be interpreted to extend to all financial reporting that occurs on the "as of" date. For example, management's assertion on internal control effectiveness over financial reporting of a consolidated entity could be interpreted by the user community to include: financial statements issued by each of the subsidiaries in accordance with generally accepted accounting principles or another comprehensive basis of accounting, and reporting of financial information at a consolidated and subsidiary level to government agencies, such as the Internal Revenue Service. Accordingly, we suggest that the Board clearly define the term "internal control over financial reporting" and limit it to the specific financial statements covered by the report, for example, the financial statements required to be filed in accordance with generally accepted accounting principles and SEC rules and regulations under the Securities Exchange Act of 1934. For example, the introductory paragraph may be worded as follows:

> We have audited management's assertion, included in the accompanying [*title of management's report*], that W Company maintained effective internal control over financial reporting as of December 31, 20X3 in the Company's financial statements filed with the Securities and Exchange Commission, based on [*Identify criteria, for example "criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organization of the Treadway Commission (COSO)."*].

Questions Regarding Auditor Independence

28. Should the Board provide specific guidance on independence and internal control-related services in the context of this proposed standard?

Although we believe the Board should provide specific guidance and adopt certain rules on independence and internal control-related matters, as indicated in our response to question number 29, the Board should not provide them within this standard. We suggest that independence matters not reside directly in the auditing and other attest standards. Such matters should exist independently, through separate independence standards or the SEC's rules and regulations.

An auditor is required to adhere to all requirements imposed by the PCAOB's Auditing and Related Professional Practice Standards and those imposed directly by the SEC. Accordingly, it is not necessary to repeat such requirements in multiple locations (and can even be burdensome for the regulators to maintain). A reference to the relevant standards, rules and regulations is sufficient and does not alter the auditor's responsibilities. Additionally, it promotes compliance with the standards, rules and regulations, as such information is contained within the related subject matter.

29. Are there any specific internal control-related non-audit services the auditor should be prohibited from providing to an audit client?

We believe that the Board should adopt Grant Thornton's position on independence in regards to internal control-related services by the external auditor. Our position is expressed in the following excerpt from a testimony given by Ed Nusbaum, Grant Thornton's Chief Executive Officer, on September 23, 2003, before a full committee hearing of the U.S. Senate Committee on Banking, Housing and Urban Affairs, the subject: "The Implementation of the Sarbanes-Oxley Act and Restoring Investor Confidence."

> "…The degree of an auditor's independence is driven by the separation between management (which produces the financial information) and the users of the information provided by management. The standard for independence is heightened as that separation increases. We firmly believe that the auditors of publicly held companies must hold themselves to the highest possible standard of independence.
>
> For this reason, Grant Thornton will not accept engagements to document, evaluate or design our public audit clients' internal controls, including engagements to document existing controls, or to perform evaluations of existing controls that management uses to support their conclusions regarding the effective design of those controls. To do so, we feel, is a conflict of interest. Instead, as auditors, we will audit the internal controls as designed, documented and evaluated by management, in accordance with the provisions of the Act."

Questions Regarding Auditor's Responsibilities with Regard to Management's Certifications

30. Are the auditor's differing levels of responsibility as they relate to management's quarterly certifications versus the annual (fourth quarter) certification, appropriate?

The differing levels of responsibility as they relate to management's quarterly and annual certifications are appropriate and are consistent with the current reporting model. For example, the accountant performs a review of the company's interim financial information and management's quarterly 302 certifications (as it relates to the disclosure of any material change in internal control over financial reporting during the period), while he or she performs an audit of the company's annual financial statements and management's assertion of the effectiveness of internal control over financial reporting. However, we do believe that the responsibility for the accountant to determine whether significant changes in internal control over financial reporting may introduce significant deficiencies or material weaknesses in the design of internal control over financial reporting discussed in paragraph 186 is inconsistent with the objective of a review of interim financial information.

The objective of a review of interim financial information pursuant to AU Section 722, *Interim Financial Information,* is to provide the accountant with a basis for communicating whether he or she is aware of any material modifications that should be made to the interim financial information for it to conform with generally accepted accounting principles. A review consists principally of performing analytical procedures and making inquiries of persons responsible for financial and accounting matters, and does not contemplate tests of accounting records through inspection, observation or confirmation. We believe that paragraph 186, as currently written, creates a responsibility that is inconsistent with the objective of a review of interim financial information. We suggest the following language as an alternative:

> "If there have been significant changes in the design or operation of internal control over financial reporting, perform procedures to obtain sufficient knowledge to understand the effect of such changes on internal control as it relates to the preparation of interim financial information and inquire of management whether such changes may introduce significant deficiencies or material weaknesses in the design of internal control over financial reporting."

AU Section 722 addresses the matters discussed in paragraphs 185 through 188. We urge the Board to consider revising this section in light of AU Section 722, and in lieu of providing such guidance in the proposed standard, amend AU Section 722 for the requirements of Section 302 and make reference to the guidance in AU Section 722 in the proposed standard. We also urge the Board to use "accountant" rather than "auditor" when discussing interim reviews in paragraphs 185 through 188 to be consistent with AU Section 722.

31. Is the scope of the auditor's responsibility for quarterly disclosures about the internal control over financial reporting appropriate?

Please see our response to question number 30. The scope of the accountant's responsibility for quarterly disclosures should be consistent with the accountant's responsibility for material misstatements of interim financial statements under AU Section 722.

Appendix B – Specific Paragraph-Level Comments

The following describes additional concerns and offers other substantive comments and/or suggestions relating to specific paragraphs.

- **Footnote 1** – Where the PCAOB believes that there will be any need or request for an audit of internal control over financial reporting other than those mandated by Section 404 of the Sarbanes-Oxley Act, they should maintain a standalone standard for such attestation engagement. Please see our response to question number two.

- **Paragraph 7** - A deficiency in operation is described, among other things, as one where a person performing the control does not possess the necessary authority or qualifications to perform the control effectively. This is an element of design, as well as operation. For example, assigning the appropriate individual to perform a control (e.g., segregation of duties) relates to design. Whether the assigned individual performed the control and how well that person performed the control relates to operation. We suggest that the Board revise the definitions of a design deficiency and an operating deficiency, accordingly.

- **Paragraphs 21 and 22** – We believe that the concepts in these paragraphs need clarification. These paragraphs should clearly state that materiality, as it is described herein, relates to evaluating the severity of internal control deficiencies to determine whether they are significant deficiencies and material weaknesses, rather than used for purposes of performing the audit of internal control over financial reporting. In addition, the proposed standard should not suggest that we conduct the audit at a lower level of materiality at the individual account-balance level. Paragraph 61 describes that an account is significant if there is more than a remote likelihood that the account could have a material effect on the financial statements. Accordingly, the audit would be planned in consideration of materiality at the financial statement level.

- **Paragraph 36** - The last sentence of this paragraph states "Inquiry of management and employees is the beginning point for obtaining an understanding of internal control over financial reporting, but inquiry alone is not adequate for reaching a conclusion on any aspect of internal control over financial reporting effectiveness." We believe that the word "any" should be deleted. In many instances, inquiry may be the only procedure that can be performed to support the effectiveness of a "single" control. Inquiry alone is not sufficient to support our opinion on management's assertion, but may be sufficient to support a conclusion that certain controls are operating effectively.

- **Paragraph 61** - The definition of a significant account would seem to allow the auditor some latitude in determining which accounts will require testing, for example limiting work to those where a material misstatement could exist rather than requiring testing for either quantitative or qualitative materiality. This approach, however, seems to be at odds with the example in B18. For instance, if the auditor were to conclude that the likelihood of a misstatement of the property, plant and equipment account is remote in the example presented, we would argue that we do not need to test controls over that account solely on the basis of the materiality of the balance to the financial statements.

- **Paragraph 74** – This paragraph lists items that should be evaluated by the auditor when identifying controls to test. With respect to the third bullet, we recommend replacing the phrase "whether more than one control achieves a particular objective" with the phrase "whether more than one control is necessary to achieve a particular objective." In regards to the fourth bullet, the auditor should not consider the nature and extent of tests performed by management and others when determining which controls to test. The auditor should make his or her own judgment as to which controls should be tested and then determine the nature, timing and extent of the tests to be performed directly (or tests to reperform the work of management and others). With respect to the very last item, we do not believe that the complexity of the control is a consideration. Processes and systems may be complex; however, individual controls are quite simple.

- **Paragraph 88** – Please refer to our comments for paragraph7 regarding the definitions of a design deficiency and an operating deficiency.

- **Paragraph 92** – This paragraph states, "Because inquiry alone does not provide sufficient evidence to support the operating effectiveness of a control, the auditor should perform additional tests of controls." Please see our comments relating to paragraph 36. Inquiry may be a sufficient procedure for evaluating "a" single control.

- **Paragraph 136** – This paragraph states, "To assess control risk for specific financial statement assertions at less than maximum, the auditor is required to obtain evidence that the relevant controls operated effectively during the entire period covered by the company's financial statements." We disagree with this statement. The auditor should test controls over the period in which the controls are being relied upon, which may not be the entire period covered by the financial statements. Other substantive procedures can be performed to cover the "stub-period." Together, such procedures would be sufficient to reduce audit risk to an appropriately low level.

- **Paragraph 139** – We suggest defining the term "significant risk," as it is not currently defined in the interim standards.

- **Paragraph 140** – We suggest the following revision: "For this reason, substantive analytical procedures **alone** are not well suited to detecting fraud." Perhaps there are situations where substantive analytical procedures alone may not be effective; however, we disagree that they are never effective as the statement implies. For example, the performance of disaggregated analytical procedures over revenue may assist in detecting fraud or potential fraud.

- **Paragraph 143** – This paragraph requires the auditor to evaluate his or her findings from substantive procedures performed in the audit of the financial statements and their effect on the effectiveness of internal control over financial reporting. It also lists matters the auditor should include when performing such an evaluation. We believe the requirement to evaluate **all** findings is unnecessary and improperly excludes the auditor's professional judgment and consideration of materiality and the significance of the finding. In addition, certain matters listed do not represent findings from substantive procedures (e.g., risk evaluations), and the impact on internal control effectiveness is not necessarily apparent from some of the items presented (e.g., findings with respect to related party transactions). Accordingly, we urge the Board clarify its intents with respect to this paragraph and eliminate the requirement to evaluate **all** findings.

- **Paragraph 145** – The proposed standard requires the auditor to document "the process used to determine significant accounts, classes of transactions, and disclosures, including the determination of the locations or business units at which to perform testing." We suggest that the Board clarify what is meant by this documentation requirement, including what the Board expects to be documented. For example, could the process be a firm's methodology?

- **Paragraphs 146 & 147** – This paragraph states "The auditor also should document the effect of a conclusion that control risk is other than low for any relevant assertions for any significant accounts on his or her opinion on the audit of internal control over financial reporting." We suggest that the Board clarify the documentation requirements and the auditor's control risk assessments. For example, the matters described in paragraph 146 may alter the control risk assessment for the audit of the financial statements. By definition, control risk is the risk that a material misstatement in an assertion will not be prevented or detected on a timely basis by internal control policies or procedures. Accordingly, with respect to the audit of internal control, we believe that only a material weakness precludes the auditor from assessing control risk at low. As such, the items in paragraph 146 would preclude the issuance of an unqualified opinion on the effectiveness of internal control over financial reporting.

- **Paragraph 163** – As indicated in our response to question number 21, where the auditor identified a material weakness that was not identified by management, this in itself may be a material weakness. Accordingly, clarification of the second bullet point may be necessary.

- **Paragraph B15** – The last sentence of this paragraph states "The evaluation ordinarily would not extend to controls at the equity method investee." We suggest that the PCAOB delete the word "ordinarily," as it extends beyond the scope of the auditor's responsibilities.

- **Example B-1** – The extent of the expected information technology testing is a concern; it would appear that an information technology expert will need to be involved on all audits for all information technology processes that the auditor relies on to independently verify that there were no changes made in the system, or that the system was put in operation on the date the client maintained. Inquiry of the company's information technology manager will be insufficient in and of itself to audit the changes to the system. Nor would we be able to rely on a change log kept by the information technology manager, as it would be subject to alteration/manipulation.

Appendix C – Other Recommendations

The following represent other recommendations.

- **Footnote 1** – We suggest that in lieu of stating the "standard does not apply," stating that the "standard applies to a limited extent," when an auditor audits the financial statements but does not audit a company's internal control over financial reporting.

- **Paragraph 5** – In the first sentence, we recommend replacing the word "operated" with the word "operating" or replacing the word "is" with the word "was."

- **Footnote 9** – The Board may also choose to add a reference to Staff Accounting Bulletin No. 99, *Materiality*.

- **Paragraph 18** – We suggest that the Board clarify the level of assurance provided by management versus that provided by the auditor. Specifically, an explanation as to why the auditor does not provide the "same assurance" as management would be helpful.

- **Paragraph 24** – With respect to the controls that address the risk of fraud, we agree that the auditor should pay particular attention to the control environment; however, given this requirement is presumptively mandatory, we suggest the Board clarify their intent with respect to the term "special emphasis."

- **Paragraph 27** – We suggest adding a cross-reference to where the phrases "relevant financial statement assertions" and "significant accounts and disclosures" are defined.

- **Paragraph 39** – This paragraph describes certain matters the auditor should evaluate when planning the audit to determine the affect on his or her procedures. We suggest adding a cross-reference to paragraph 101, which discusses altering the nature, timing and extent of testing to introduce an element of unpredictability and to respond to changes in circumstances.

- **Paragraphs 48-50** – We recommend linking the term "specific controls" to the requirement to evaluate controls over "relevant assertions and significant account balances."

- **Paragraph 113** – The schedule of passed adjustments and the adjustments recorded by management are an important element to consider when forming an opinion on internal control over financial reporting. Accordingly, a specific mention of such is appropriate within this paragraph.

- **Paragraph 157** – This paragraph discusses that the date of the auditor's report on the financial statements and the date of the auditor's report on the audit of internal control should be the same. We suggest the Board consider the impact of dual-dating for subsequent events. We believe that a dual-date for a subsequent event relating to either opinion should not impact the date of the other report.

- **Paragraph 168 –** The SEC staff has provided certain guidance with respect to meeting the requirements of a principal auditor for a financial statement audit. We suggest the Board clarify such requirements and their applicability to an audit of internal control over financial reporting.