Walkthrough Requirements
AS 5 requires the performance of walkthroughs for each significant process, but changes the requirements such that an external auditor is no longer required to perform a walkthrough for each major class of transactions within each significant process. While this recalibration of walkthrough requirements noted in AS 5 may result in efficiencies, greater benefit could be derived with further allowances in several areas:

1. *Supervision of Walkthroughs*: AS 5 allows for the external auditor to utilize the direct assistance of others when performing the required walkthroughs, provided the external auditor properly supervises the work performed. It would be helpful if the guidance confirmed that an appropriate means for achieving the 'standard of supervision' could be that the auditor defined specific walkthrough procedures and deliverable. The walkthrough procedures could then be executed by company resources and the specified deliverable provided to the auditor. This arrangement would be more efficient than an arrangement where the auditor supervises the company resources as if they worked for the auditor.

2. *Auditor Judgment for Performing Walkthroughs*: AS 5 does not allow the external auditor to apply judgment (e.g., giving consideration to such factors as prior year control evaluation, auditor knowledge of area, degree of process change) in determining which significant processes a walkthrough must be performed. Walkthroughs are very time consuming and costly. For significant processes that are extensively audited annually and thus the auditor is very knowledgeable, the benefits of a walkthrough are not derived. Further, in those areas that have lower relative inherent risk and do not change significantly year over year (e.g., Payroll Expense) very little value from a walkthrough is gained. It would be helpful if the guidance provided greater flexibility for the auditor to apply judgment in determining the area for which a walkthrough is performed and the frequency of a walkthrough.

3. *Reliance on Walkthrough for Controls Evaluation*: AS 5 indicates that walkthroughs alone are sufficient evidence for the auditor to conclude on the operating effectiveness of key financial reporting controls. However, regardless of the inherent risk or materiality in certain areas, paragraph B9 requires substantive procedures (above the performance of a walkthrough) in order to opine on the financial statements. Similar to the points noted above related to the application of auditor judgment in determining what area and how frequently to perform a walkthrough, it would be helpful if the guidance allowed the auditor to use judgment and rely on the results of a walkthrough (specifically for low inherent risk controls such as Fixed Assets) as sufficient evidence to opine on the financial statements.

Company-Level Controls
AS 5 guides the auditor to test those company-level controls that are important to the auditor's conclusion about whether the company has effective internal controls over financial reporting. The auditor's evaluation of company-level controls can result in increasing or decreasing the testing that the auditor otherwise would have performed on controls at the process, transaction, or application levels. While this guidance of using a top-down approach to the audit of internal controls over financial reporting may result in efficiencies, greater clarity would be helpful in several areas:

1. *Definition of Company-Level Controls*: In paragraph 18 of AS 5, a description of what is meant by a company-level control is provided. Further, in paragraph 43 of AS 5, the

guidance suggests that the auditor should give consideration to which company-level controls to test as company-level controls operate at varying levels of precision. It would be helpful if the guidance provided specific examples of company-level controls that operate at varying levels of precision that by themselves would sufficiently address the assessed risk that misstatements to a relevant assertion will be prevented or detected in a timely basis. It is often difficult to identify 'key' company-level controls that have a direct, clear linkage to mitigating risk associated financial misstatement. As such, auditors have placed little reliance on company-level controls in the past. If the guidance were expanded to include specific examples of company-level controls at the process level, transaction level, and application level that might adequately prevent or detect on a timely basis misstatements, this would provide clarity and result in the ability for auditors to place greater reliance on company-level controls as intended.

2. *Evidence to Demonstrate Operating Effectiveness of Company-Level Controls*: AS 5 allows greater reliance by auditors on company-level controls. In conjunction with greater clarity on the definition of company-level controls (at the process, transaction, and application level) that operate at the appropriate degree of precision for the auditor to place reliance, it would be helpful if the guidance commented on the nature, extent, and timing of 'key' company-level control evidence that would be sufficient for the auditor to place reliance upon. For example, for the following process level, company control, is the suggested audit evidence sufficient?
    - Key process level, company control: On a monthly basis, the Funding and Investments department performs a trend analysis of interest income and expense to validate that the income/expense levels are appropriate and in accordance with management expectations. This monthly trend analysis includes a review of several specific data elements month over month (e.g., investment balance, debt outstanding, interest rate.)
    - Suggested control evidence: For two months from different quarters obtain the following: (1) procedures for performing and reviewing trend analysis with notation on specific data elements reviewed and managements tolerable variance, (2) a copy of management's trend analysis and review, (3) evidence of management's review & approval, and (4) evidence of research and resolution for any identified data anomalies.

Submitted by William M. Diefenderfer, Sallie Mae, Audit Committee Chairman. 703-759-0822