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SOUTHERN COMPANY
*Energy to Serve Your World®*

February 23, 2007

Mr. J. Gordon Seymour
Deputy General Counsel and Secretary
Public Company Accounting Oversight Board
1666 K Street N.W.
Washington, D.C. 20006-2803

RE: PCAOB Rulemaking Docket Matter No. 021

FILED ELECTRONICALLY (comments@pcaobus.org)

Dear Mr. Seymour:

We appreciate the Public Company Accounting Oversight Board's ("PCAOB") effort to solicit feedback on the proposed auditing standards, "An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements" and "Considering and Using the Work of Others in an Audit." Overall, we continue to support the intent and goals of Section 404 of the Sarbanes Oxley Act ("Act") and believe our Company continues to derive benefit from Section 404's requirements on management. However, we also believe that we are spending more time and resources on complying with Section 404 than is beneficial to our investors.

We believe that these proposed standards are very positive steps to increasingly efficient and cost effective internal control assessments. We especially applaud the revisions that, 1) replace the term "inconsequential" with "material," 2) replace the term "less than remote" with "reasonable possibility," and 3) expand the reliance on walkthroughs.

We observe in practice however, that disincentives for public accountants to embrace the risk based approach contained in the proposed auditing standards remain. Auditing Standard No. 2 resulted in an audit approach where every key control (even including some operational controls) was tested regardless of risk. This high degree of coverage afforded the public accountant significant protection from liability due to "missing something." Because public accountants are exposed to significant liability, they are reluctant to use judgment in any way that lessens coverage and associated audit evidence. As such, even though well constructed auditing standards such as these may exist which allow for practically applied judgments to increase efficiency, we believe that auditors will continue to exceed the intent of the proposed auditing standards in practice. They simply have no incentive to reduce testing that counter-balances their inherent goal of defending their audit opinions from liability. Further, the PCAOB's own inspections of the public accountants reinforce this behavior through commonly citing "lack of sufficient evidential matter."

We would also like to address the significant interaction that exists in practice between the guidance provided to management from the Securities and Exchange Commission ("SEC") and the auditing standards provided to public accountants by the PCAOB. While we think that the SEC's proposed interpretive guidance for management gives management the flexibility to build efficiency into the implementation of Sarbanes-Oxley Section 404, we believe the public accounting influence on management's assessment process negates this flexibility.

The SEC has acknowledged the possibility of a strong interaction between its own proposed interpretive guidance with the proposed guidance issued by the PCAOB. The SEC states the question as follows (page fifty of its proposed interpretive guidance): "Considering the PCAOB's proposed new auditing standards, <u>An Audit of Internal Control Over Financial Reporting that is Integrated with an Audit of Financial Statements</u> and <u>Considering and Using the Work of Others In an Audit</u>, are there any areas of incompatibility that limit the effectiveness or efficiency of an evaluation conducted in accordance with the proposed guidance? If so, what are those areas and how would you propose to solve the incompatibility?"

We believe that a strong interaction, as discussed above, does exist between the SEC guidance and the proposed PCAOB auditing standards. Further, we believe the SEC guidance for management is ultimately incompatible with the PCAOB's proposed new auditing standards. Management will continually seek to perform an ICFR assessment that is, foremost, effective and efficient. The public accountant will continue to perform an assessment that, foremost, creates quantities of evidence ample enough to defend its opinion and protect against litigation. Thus, from the public accounting perspective, more evidence equals less risk. Effectiveness and efficiency can only be sought after the public accounting firm's ability to defend its audit opinion is fully satisfied. The best evidence of the reality of this conflict is the need for entirely separate guidance for management and the public accountant regarding the performance of a review of the same process, that is, of internal control over financial reporting.

Given the interaction discussed above, we suggest that the solution most likely to overcome the inherent incompatibility between management's assessment process and the public accountant's assessment process is a standard that better balances the two differing perspectives. While we recognize that certain elements of the following recommendations are beyond the scope of the PCAOB's standard setting authority, it is essential that the PCAOB be mindful that any new auditing standard be fully compatible with any emerging legislative changes or SEC guidance. Ultimately, any new guidance should be based on and begin with the following actions:

- <u>**Eliminate the Section 404 (b) requirement for a public accountant opinion on ICFR.**</u> The current proposal provides no incentive for public accounting firms to limit the amount of controls documentation and testing they require in order to provide an opinion on ICFR. This results in a "more is better" tendency on the part of public accounting firms when gathering evidence of control effectiveness. More evidence obviously places the public accountant in a better position to defend their opinions. While the current proposal directs public accountants to the most important controls, there is no standard for management to rely on when debating with the public accountant on the appropriate balance of coverage. The net result is that when management presents a risk based evaluation of the number of controls to be documented and tested in its assessment of ICFR, any reductions will likely be perceived by the public accountant as imposing additional risk on the public accounting firm.

The public accountant response to a risk based management assessment that covers primarily the highest risk, most important controls, will likely be "if management won't test all internal controls over financial reporting, then we (the public accountant) will have to do more work. Thus, the most effective way to provide relief from the public accounting propensity to require more testing is to eliminate the public accountant's opinion on ICFR required by Section 404 (b). Subsequently, the public accountant would revert to the previously utilized auditing standard covering internal controls, that is, Statement of Auditing Standard No. 55, Consideration of Internal Control in a Financial Statement Audit (SAS 55). Accordingly, we advocate that the PCAOB bring forward into the new auditing standard the approach to evaluating internal controls similar to that contained in SAS 55. Adherence to SAS 55 by the public accountant, along with the certification of internal controls provided by management under Section 404 (a), would be sufficient to provide assurance of internal control effectiveness to the investing public.

- **Define the scope of the Section 404 (a) Management Assessment to eliminate or reduce compliance requirements for subsidiary registrants.** Due to the existence of corporations that contain multiple subsidiary SEC registrants, certain corporations find themselves having to certify multiple times within the same corporation. We believe that the multiple certifications required under current SEC rules are incompatible with the goal of efficiency stated by both the SEC and the PCAOB.

  To alleviate this inefficiency and redundancy, we suggest expanding the SEC Audit Committee exemption to encompass Section 404 (a) —effectively exempting or reducing compliance requirements for (subsidiary) registrants. Specifically, we recommend exemption for SEC registrants whose common stock is owned entirely by a registered holding company that also fully complies with Section 404 (a). Having management certify each subsidiary individually is an inherently redundant exercise with limited benefit to investors. A single management certification at the holding company level would provide sufficient assurance to investors that controls surrounding the financial reporting process are adequate to assure financial statements are properly stated.

Within the proposed auditing standard, the PCOAB provides guidance related to multi-location testing (Page 20, Section 3). We understand that the intent of the "multi-locations" guidance is to allow for "multiple- locations or business units" to be covered by a single assessment so structured as to provide adequate coverage of the multiple locations or business units. However, individual subsidiaries that are also "business units" have to provide individual certifications under current SEC rules. Thus, we consider the PCAOB guidance allowing multiple business units to be covered by a single assessment to be inconsistent with current SEC rules requiring individual certifications and therefore individual assessments at multiple subsidiaries.

To alleviate this inconsistency, we recommend that the PCAOB expand its guidance related to multiple locations or business units to clearly encompass the goal of having a single assessment for a corporation that has multiple subsidiaries. We feel that multiple subsidiary certifications will be confusing to investors given the variability associated with different levels of materiality at subsidiaries of various sizes within the same corporation.

- **Develop guidance that is compatible between the SEC and the PCAOB, thus enhancing the ability of the public accountant to rely on work performed by management that reflects SEC guidance.** Any incompatibility between the SEC guidance and the proposed PCAOB auditing standards ultimately lessens the ability of the public accountant to rely on work performed by management. This lessens the efficiency of the assessment and contributes to redundancy. The SEC guidance, taken alone, allows management to perform an internal control assessment with efficiency. When management alters their assessment to allow for utilization by the public accountant, the PCAOB guidance forces management to perform procedures and tests that exceed those levels suggested by the SEC's guidance, thus contributing to inefficiency.

We also have identified the following specific sections from the proposed standard that warrant further clarification:

- In paragraph 18, page A1-12, the following is cited as a company level control that must be tested—"Centralized processing and controls, including shared service environments." This bullet seems to infer that all shared services have elevated risks and must be tested. We view shared services as having superior control environments and therefore less risk than distributed processes. We suggest removing this category from the list of company level controls that the auditor must always test and leaving testing frequency of shared services and centralized controls to a risk-based determination.

- In paragraph 18, page A1-12, the following is cited as a company level control that must be tested—"Policies that address significant business control and risk management practices." This company level control is stated so broadly that it could be interpreted to include various insurance and loss minimization programs unrelated to internal control over financial reporting. We recommend this bullet be clarified to encompass only those "Policies that address significant business control and risk management practices that are material to internal control over financial reporting."

Lastly, we would like to add our endorsement of the response from the Edison Electric Institute ("EEI"). EEI is the association of United States shareholder-owned electric companies, whose members serve 97 percent of the ultimate customers in the shareholder owned segment of the industry.

We thank you for the opportunity to provide feedback on these proposed auditing standards. We look forward to your future standards to help achieve the goals of the Sarbanes-Oxley Act in a cost effective and efficient manner. If you would like to discuss our response, please contact me.

Sincerely,

/s/Thomas A. Fanning