February 26, 2007

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

RE: Rulemaking Docket No. 021

Members of the Public Company Accounting Oversight Board:

As the Public Company Accounting Oversight Board (the "Board") initially noted in their "Report on the Initial Implementation of Auditing Standard No. 2", there have been misunderstandings on how to apply this standard, which have resulted in audit inefficiencies. Our experience with the independent public accounting firm that performs our audit is that they have appeared to have chosen to err on the side of being overly effective and, therefore, inefficient when confronted with uncertainties on how to apply this standard. We also hear from our auditors that the Board's inspection and reporting processes is heavily skewed towards testing for ineffective compliance with little consideration for efficiency.

The proposed 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" provide greater clarity on how to more efficiently perform audits of internal controls. However, these changes alone will not ensure that public accounting firms fully understand how to apply these standards both efficiently and effectively. A practical understanding will rely heavily upon communications between the firms and the Board, including an appropriate balance of effectiveness and efficiency comments provided to the firms during the inspection process.

The inspection process is a critical part of these interactions. While this process may have caused firms to be overly concerned with effectiveness, this same process identified concerns over audit inefficiencies that lead to these proposed standards. We appreciate the changes the Board already made to this process focusing more on how efficiently audits are performed, as noted in the "Statement Regarding the Public Company Accounting Oversight Board's Approach to Inspections of Internal Control Audits in the 2006 Inspection Cycle". These proposed standards and the continued emphasis during the inspection process on both effective and efficient compliance will reduce costs while preserving the benefits gained from performing audits of internal control over financial reporting.

Overall, we agree with the approaches and rules outlined in these proposed standards. Therefore, the following comments are restricted to questions asked in areas where we believe better clarity can be achieved.

Q1. Does the proposed standard clearly describe how to use a top-down approach to auditing internal control?

Overall, the methodologies outlined under the section titled "Using a Top-Down Approach", paragraph 16, are clearly descriptive. This approach also appears consistent with that identified under the title "Scaling the Audit for Smaller Companies", paragraph 9. Because these sections are listed separately, this appears to indicate that a different approach should be taken when auditing smaller companies. This could lead some readers to interpret that the requirements for these companies are less stringent than larger ones, instead of simply noting the differences between them to consider when taking a top-down approach.

All companies should benefit from efficiencies gained using the top-down approach described. We believe that the considerations noted pertaining to smaller companies should be included within the top-down approach section to clarify the Board's intentions.

Q4. Does the proposed standard adequately articulate the appropriate consideration of company-level controls and their effect on the auditor's work, including adequate description of when the testing of other controls can be reduced?

We agree that the proposed standard does provide appropriate consideration of company-level controls. However, within paragraph 21, the Period-end Financial Reporting Process examples appear to focus primarily on journal entry controls. We believe that controls related to account reconcilement procedures should also be emphasized. These types of controls often initiate the recording of journal entries, as well as validate the accuracy of those posted. Per the proposed standard, auditors should consider the results of substantive audit procedures performed in the financial statement audit when determining the overall risk related to a control.

Q7. Is the proposed definition of "significant" sufficiently descriptive to be applied in practice? Does it appropriately describe the kinds of potential misstatements that should lead the auditor to conclude that a control deficiency is a significant deficiency?

Despite changes to the definition of "significant" in regards to a deficiency, this term is still not sufficiently descriptive. The Board has provided some examples of qualitative measures for determining significant deficiencies. However, no clear quantitative guidance has ever been provided in regards to determining a significant deficiency.

Within the proposed standard, paragraph 14, auditors are instructed to use the same materiality considerations used in planning the audit of the company's annual financial statements for the audit of internal control over financial reporting. While an auditor's determination of materiality should include qualitative factors, in practice this measure is primarily quantitative.

Auditors are still required to communicate, in writing, significant deficiencies, in addition to material weaknesses, identified during the audit, to management and the audit committee. The purpose of doing so is to inform those responsible for oversight of the company's financial reporting of "deficiencies important enough to merit their attention". However, the absence of a quantitative measure of a significant deficiency in context to a material weakness diminishes the substance of this type of finding. Noting their importance, we believe that the definition of a significant deficiency would be more descriptive if it were also provided in context to quantitative materiality.

Q9. Will the proposed changes to the definitions reduce the amount of effort devoted to identifying and analyzing deficiencies that do not present a reasonable possibility of misstatement to the financial statements?

When planning an audit, auditors are also instructed to identify significant accounts and disclosures. Paragraph 25 states that "the factors that the auditor should evaluate in the identification of accounts are the same in the audit of internal control over financial reporting as in the audit of financial statements; accordingly, significant accounts should be the same for both audits".

Again, auditors generally determine materiality as a quantitative threshold, based upon a percentage of a numerical threshold, such as 5% of net income before tax. Auditors then determine tolerable misstatement, based upon materiality, as a quantitative measure, in addition to qualitative factors, to identify "significant" accounts during the planning process. The purpose of determining significant accounts and disclosures within a financial audit is to obtain reasonable assurance of detecting misstatements that could be large enough, individually or in the aggregate, to be quantitatively material to the financial statements.

However, within this proposed standard, paragraph 8, references are made such as "it is not necessary to test controls that, even if deficient, would not present a reasonable possibility of material misstatement to the financial statements". This statement appears to contradict that within paragraph 25, as noted above. While we believe that the phrase "reasonable possibility of material misstatement" means that auditors only concern themselves with deficiencies that could individually or in combination become material weaknesses, this could be misinterpreted. Auditors may take such statements to indicate that they should only search for individual material weaknesses.

We believe that firms should not search for deficiencies that individually or in the aggregate could not present a reasonable possibility of being a material weakness. The objective of an audit of internal controls over financial reporting is to obtain reasonable assurance that material weaknesses do not exist. We recommend that these statements, such as that noted above, should emphasize that material weaknesses, as defined, can be an individual deficiency or a combination of deficiencies. The previous example should indicate that "it is not necessary to test controls that, even if deficient, would not present a reasonable possibility, individually or in the aggregate, of being a material misstatement to the financial statements".

This proposed revision also appears consistent with the definition of a significant account, "an account or disclosure is significant if there is a reasonable possibility that the account could contain a misstatement that, individually or when aggregated with others, has a material effect on the financial statements".

Q8. Are auditors appropriately identifying material weaknesses in the absence of an actual material misstatement, whether identified by management or the auditor? How could the proposed standard on auditing internal control further encourage auditor to appropriately identify material weaknesses when an actual material misstatement has not occurred?

As noted above, statements within the proposed standard should be revised to ensure that auditors do not misinterpret them and plan their audits to only identify individual deficiencies that could be material weaknesses. The failure to adequately identify deficiencies that in combination could present a reasonable possibility of being a material weakness could hinder the Board's intention to further encourage auditors to appropriately identify material weaknesses when an actual material misstatement has not occurred.

Q18. Will the proposed standard's approach for determining the scope of testing in a multi-location engagement result in more efficient multi-location audits?

Applying the top-down approach to determine those locations and business units should result in more efficient audits of multi-location engagements. Particularly, the note after paragraph B12 that "the auditor may eliminate from further consideration locations or business units that, individually or when aggregated with others, do not present a reasonable possibility of material misstatement to the company's consolidated financial statements" summarizes this top-down risk-based approach.

However, there is no reference to this approach within the section titled Multiple Locations Scoping Decisions. The guidance provided under the section "Using a Top-Down Approach" addresses considerations for the company-level controls, e.g., centralized processing and controls, monitoring of operations, and the control environment that when applied to individual locations or business units should reduce the scope of testing. We believe that the Multiple Locations Scoping Decisions section would be enhanced by including specific references to the top-down approach.

Similar to previous concerns noted, paragraph B13 notes that "in assessing and responding to risk, the auditor should test controls over specific risks that present a reasonable possibility of material misstatement to the company's consolidated financial statements". We suggest that this statement be revised accordingly, "the auditor should test controls over specific risks that present a reasonable possibility, individually or in aggregate, of material misstatement" to ensure that auditors use an effective approach to scoping their audits.

Again, we appreciate the Board's efforts to make audits of internal control over financial reporting more efficient, and we thank you for the opportunity to provide our comments on these proposed standards.

Sincerely,

Thomas C. Wilson,
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Acuity Brands, Inc.