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February 26, 2007

Office of the Secretary
PCAOB
1666 K Street N.W.
Washington, D.C. 20006-2803

Dear Sirs

Re: PCAOB Release No. 2006-007; Docket Matter No. 021

We appreciate the opportunity to respond to the Public Company Accounting Oversight Board's (PCAOB) proposed new standard "An Audit of Internal Control Over Financial Reporting That is Integrated with an Audit of Financial Statements". ACE Limited's management and Audit Committee support the PCAOB's objective to create an auditing standard that preserves the intended benefits without resulting in unnecessary effort and costs so audits become more efficient, risk-based and scaled to the size and complexity of each company.

At ACE, we continue to support the concept of having external auditors assess and report on the effectiveness of Internal Controls over Financial Reporting (ICFR) each year and congratulate the PCAOB on taking steps to address the unintended consequences related to these external audits of ICFR. We agree that the proposed standard is easier to read and has particular benefits for smaller companies. It is also helpful in that it codifies earlier guidance calling for a risk-based approach to auditing ICFR. Furthermore, we recognize that the PCAOB is charged with overseeing audit firms that range in size and complexity, and the expected impact of proposed standards will differ between firms and companies. Thus, any impact from this proposed standard will ultimately need to be measured at the company level and we expect that companies will experience different degrees of savings and efficiencies based on this proposed standard.

The Sarbanes-Oxley Act was created in response to a number of significant frauds that had occurred relating to financial reporting. The activities that promulgated the fraudulent reporting were orchestrated by very senior members of management and had little relevance to transaction-level controls. However, both management's annual assessment and the external auditor's annual evaluation of ICFR currently focus significant resources on transactional-level controls. Fraudulent financial reporting of a material nature will normally involve the knowing approval and active involvement of executive management. Therefore, given the genesis of the Act, we would expect that our assessments would focus on the potential means of fraudulent financial reporting, including significant transactions such as late or unusual journal entries, improper related-party transactions, and over-riding of existing reports and financial data which are not routinely detected by transactional-level controls. We believe that without further focus on



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the key controls that pose the most significant risk to false financial reporting, there is little opportunity to reduce management and auditor testing efforts.

In other words, we believe testing should shift dramatically away from transactional-level controls to company-level controls in a way that impacts the required audit efforts in a similarly dramatic way. The PCAOB should provide guidance and examples to make it very clear that detailed transactional-level control testing deep in an organization is not required. The focus should be on assessing the types of company-level controls that, left unchecked, contribute to audit failures in cases of significant fraud.

With respect to the current proposed standard, in our view, there are three key questions that should be addressed:

1. Will the proposed standard preserve the intended benefits of the audit of ICFR?
2. Will the proposed standard cause auditors to create a more cost efficient approach to auditing ICFR, and, if so, will it result in a significant fee reduction?
3. Will the elimination of the requirement to evaluate management's process used to assess internal controls over financial reporting result in reduction of audit costs?

1. Will the proposed standard preserve the intended benefits of the audit of ICFR? The proposed standard suggests a risk-based approach that starts with assessing company-level controls and assesses transactional-level controls as necessary based on the level of residual risk remaining after the assessment of company-level controls. In our view, this approach not only preserves the intended benefits of the audit of ICFR but should enhance them by further focusing auditors on areas of risk to financial reporting. It is also generally consistent with the proposed interpretive guidance recently issued by the Securities and Exchange Commission.

2. Will the proposed standard cause auditors to create a more cost efficient approach to auditing ICFR, and, if so, will it result in a significant fee reduction? Based on a comparison of AS2 to the proposed standard we believe it provides for sufficient changes that, in our view, should drive significant reductions in hours and costs. However, much of what is contained in the proposed standard is formalizing concepts and ideas emanating from previous PCAOB roundtables and other public forums. These areas include identifying the scope of the assessment and using some flexibility in testing lower risk areas. As a result, based on discussions with peers and external audit firms, we do not expect this proposed standard to have a significant impact on future audit costs, principally because a good portion of this guidance has already been considered in current audit plans.

Set out below are what we consider the more significant issues:

- We believe the external auditor's evaluation is being adversely influenced by the current PCAOB inspection process. It is our view that there is a disconnect between the objectives of the PCAOB as publicly stated and the tone and content of the detailed inspections. The current timing of



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these reviews is also an issue in our view. The results of the PCAOB inspections are publicized as much as two years after the audits were performed and, in some cases, the results have generated more work for auditors by proscribing work in areas of judgment. We believe having the PCAOB reviews more timely and more focused on the publicly stated objectives would be beneficial to all constituents.

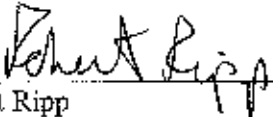
- While we believe greater reliance on company-level controls will enable improved effectiveness and efficiencies, the existing limitations within AS2 restricting the auditor's reliance on the testing of management for company-level controls inhibits the ability to reduce the audit efforts and place greater reliance on management's testing. If increased focus is to be given to company-level controls, specific guidance regarding the work of others in this area would be helpful.
 - The proposed standard focuses on using the work of others as a way to reduce the cost of the integrated audit. We are pleased this area is a central theme as we see it as an area with potential for cost savings. However, as noted in our answer to question 23 in Appendix A, this efficiency will continue to be difficult to achieve. We think more should be done to find ways to place greater reliance on management activities including regular monitoring and testing. This could have a substantial impact on costs. Relying on the work of Internal Audit does result in some cost savings but they are much less significant as Internal Audit has to carry additional staff to meet the added demand versus relying on management activities that occur as part of management's control framework.
 - A potential positive aspect of the proposed standard is the flexibility to use the work of others in the performance of walkthroughs. We do expect that this provision will allow external auditors to reduce the amount of time spent in this area.
3. *Will the elimination of the requirement to evaluate management's process used to assess internal controls over financial reporting result in reduction of audit costs?* We do not expect that the elimination of the opinion based on the current requirement to evaluate management's process will result in significant audit cost savings. Our understanding is that external auditors currently gain most of their evidence to support their opinion from their independent assessment of internal controls. Also the proposed standard indicates that the auditor should still understand management's process as a starting point to understanding a company's internal controls, assessing risk and determining the extent to which an auditor can rely on the work of others. We do believe this change will eliminate a level of confusion caused by having two opinions from the external auditor.



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In Appendix A, we have included our responses to the 34 questions posed in the proposed standard. We would be pleased to discuss our response with the PCAOB or its staff.

Sincerely



Robert Ripp
Audit Committee Chairman



Philip V. Hancock
Chief Financial Officer

A. Focusing the Audit on the Matters Most Important to Internal Control

1. Directing the Auditor's Attention Towards the Most Important Controls

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

Response

The proposed standard emphasizes "risk-assessment" and "reliance on company-level controls" as essential elements of a top-down approach. However, few if any companies and their auditors feel they have not embraced both concepts. Implementation of both concepts to streamline the audit process is hindered by a lack of detailed examples or models from which to draw upon. Risk assessment has included a financial mapping exercise to determine materiality, but assessments that incorporate risk in the equation are fairly limited. For example, in the scoping of investment activities, materiality limits the auditor's ability to reduce activities in this area even though risk of a material error is very low. Reliance on company-level controls has proven even more troubling since auditors often view these controls as necessary components of a COSO framework, yet have not been able to draw linkage to the ability of company-level controls to reduce testing of transaction level controls. Further clarity on the definition of company-level controls and the ability to leverage associated testing would be useful.

2. *Does the proposed standard place appropriate emphasis on the importance of identifying and testing controls designed to prevent or detect fraud?*

Response

Yes, we think the emphasis placed on fraud in the proposed standard is appropriate.

3. *Will the top-down approach better focus the auditor's attention on the most important controls?*

Response

Yes, a top-down approach does provide better focus for the auditor. However, the top-down approach has already been implemented to some degree by companies and auditors so the impact of this may not be substantial.

4. *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 or eliminated?*

Response

There are substantial benefits to be derived from increased reliance on company-level controls. Activities such as Balance Sheet Fluctuation analysis provide an important control in the identification of material errors. However, these company-level controls are more often viewed as additional compensating controls for other transaction level controls and not primary controls on which reliance can be placed. The standard does not sufficiently articulate how the company-level controls should affect the auditor's work as it does not provide specific examples of how a company-level control would reduce or eliminate transactional-level testing. In addition, there is a sense that the PCAOB inspection process may restrict auditor's ability to reduce testing and documentation of transactional-level controls.

2. Emphasizing the Importance of Risk Assessment

5. *Does the proposed standard appropriately incorporate risk assessment, including in the description of the relationship between the level of risk and the necessary evidence?*

Response

Additional detailed examples are critical to allow both the auditor and companies to understand the extent to which “testing” and “reperformance” would not be required in lieu of a walkthrough or observation for areas with lower levels of risk.

6. *Would the performance of a walkthrough be sufficient to test the design and operating effectiveness of some lower risk controls?*

Response

For areas that involve recurring activities with no substantive changes from prior years, walkthroughs would appear to be appropriate if management can also identify associated monitoring controls that would identify significant deviations from expected results or forecasts. Limited testing would be necessary in such cases if combined with a robust walkthrough process. Clarity regarding such examples would be helpful.

3. Revising the Definitions of Significant Deficiency and Material Weakness

7. *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?*

Response

The proposed definition is helpful, but, in our opinion, does not significantly vary from the existing standard. Further detailed examples could be helpful in understanding the precise application of the proposed standard. Also, the risk of aggregation of deficiencies will continue to drive auditors to lower levels of detail.

8. *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 auditors to appropriately identify material weaknesses when an actual material misstatement has not occurred?*

Response

In our experience, auditors are highly cognizant of control weaknesses that could “potentially” result in a material misstatement regardless of the existence of an accounting error. This awareness should be driven from the risk assessment and associated audit planning process which evaluates areas of potential risk. This further assessment of material weaknesses should include a review of historical errors, changes in management personnel, and other factors that will reduce the overall risk an actual material misstatement would occur.

9. *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 material misstatement to the financial statements?*

Response

Our interpretation of the revised standard suggests that auditors not being required to search for deficiencies that are less severe than a material weakness would result in substantial savings of effort. However, the implementation of this concept is substantially hindered by the requirement for the auditor to issue an opinion over the effectiveness of internal controls. In our experience, a significant number of control deficiencies are currently identified that do not have the potential to represent a material weakness, yet the audit process is not weighted to proportionately reduce control testing. Furthermore, the consideration of aggregation of deficiencies that could present a material weakness will require a lower level of testing and analysis of deficiencies. Additional guidance and detailed examples will be necessary to provide auditor's with the ability to take advantage of this element of the proposed standard.

As noted earlier in this response, the perception that the PCAOB inspection process focuses on non-material documentation matters creates a constraint in moving toward an increased "materiality" and "judgment-oriented" focus.

4. Revising the Strong Indicators of a Material Weakness

10. *Should the standard allow an auditor to conclude that no deficiency exists when one of the strong indicators is present? Will this change improve practice by allowing the use of greater judgment? Will this change lead to inconsistency in the evaluation of deficiencies?*

Response

The clarity provided regarding the existence of strong indicators is helpful to avoid the risk that auditors will be compelled to identify a significant deficiency when the actual control environment may suggest otherwise. This guidance will also have an impact in situations where a design deficiency existed in a previous period and is being substantially reengineered yet not completed during the current reporting period. Permitting a more judgmental evaluation of such situations would allow management to seek more strategic solutions to existing problems rather than being constrained to completely remediate significant control design issues within the existing reporting period.

6. Clarifying the Role of Interim Materiality in the Audit

11. *Are further clarifications to the scope of the audit of internal control needed to avoid unnecessary testing?*

Response

We do not believe that additional clarification is needed, other than those noted above and below.

12. *Should the reference to interim financial statements be removed from the definitions of significant deficiency and material weakness? If so, what would be the effect on the scope of the audit?*

Response

The reference to interim financial statements should be removed from the definitions to make the standard clearer. However, we do not believe that any significant scope changes would result from this action.

B. Eliminating Unnecessary Procedures

1. Removing the Requirement to Evaluate Management's Process

- 13. Will removing the requirement for an evaluation of management's process eliminate unnecessary audit work?*

Response

The evaluation of management's process has been incremental to the overall audit effort and does not require a significant amount of additional time by auditors. The removal of this requirement is not expected to have a significant impact on the audit work as auditors are still required to render an opinion on the effectiveness of internal controls. If there is even reasonable coordination with the auditor during the execution of audit work, the auditor will have been continuously evaluating management's assessment process regardless of the requirements in the standard. Coordination between management, Internal Audit and external auditors has increased the synergies between companies and their auditors, making the evaluation of management's process less arduous.

- 14. Can the auditor perform an effective audit of internal control without performing an evaluation of the quality of management's process?*

Response

Yes. Many companies have significantly relied upon their Internal Auditors and other qualified individuals to coordinate their annual evaluation. On a quarterly and annual basis, both the auditor and management are also reporting on the progress of internal control assessments directly to the Audit Committee. Due to the continuous nature of the monitoring and reporting on ICFR, the evaluation process has become a more integrated process. Effective integrated audit planning and quarterly status reporting essentially fulfill the objectives set forth in the formal evaluation process. Therefore, we feel that not requiring a formal evaluation will not result in significant changes to existing audit plans.

- 15. Will an opinion only on the effectiveness of internal control, and not on management's assessment, more clearly communicate the scope and results of the auditor's work?*

Response

Yes

2. Permitting Consideration of Knowledge Obtained During Previous Audits

- 16. Does the proposed standard appropriately incorporate the value of cumulative knowledge?*

Response

Although the concepts in the proposed standard are articulated clearly, the application of this concept is more difficult to define. We believe that in areas such as payroll and other routine processes experiencing little change, there is no substantial risk that would necessitate testing each year. While management should retain the discretion to test more frequently, we believe that further guidance and examples may be necessary to provide the auditor with sufficient guidance to determine when testing is not necessary.

17. *What are the circumstances in which it would be appropriate for the auditor to rely upon the walkthrough procedures as sufficient evidence of operating effectiveness?*

Response

As noted in question 16 above, situations with minimal change in people or processes, repetitive type processes or transactions, and low rates of historical control deficiencies would be well suited for walkthrough reliance. There may also be circumstances where significant systematized processes could rely on a walk-through if the IT General Controls over change management and user access processes are deemed effective. The requirement that auditors still issue an opinion with respect to the effectiveness of a company's ICFR makes it more unlikely auditors will forego testing in lieu of a walkthrough unless more specific guidance is provided.

3. Refocusing the Multi-Location Testing Requirements on Risk Rather than Coverage

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

Response

We do not feel this aspect of the proposed standard will significantly impact external audit efforts at ACE as we have captured the spirit of this guidance in our financial scoping efforts when considering remote locations. The proposed standard could result in more efficient audits for companies with different circumstances.

4. Removing Barriers to Using the Work of Others

19. *Is the proposed standard's single framework for using the work of others appropriate for both an integrated audit and an audit of only financial statements? If different frameworks are necessary, how should the Board minimize the barriers to integration that might result?*

Response

The proposed standard's single framework for using the work of others is appropriate for both types of audits. To apply different frameworks to an audit of financial statements only and an audit of financial statement balances in an integrated audit would be confusing and potentially lead to two standards for similar audits. We believe, the requirement to issue an opinion on the effectiveness over internal controls creates added risk to audit firms when placing further reliance on the work of others. Inherent limitations will continue to exist in expanding reliance on the work of others unless the "opinion" requirement is eliminated. Audit firms will continue to perform independent testing as long as they believe the PCAOB inspections will hold them to the standards imposed by the opinion requirement.

20. *Does the proposed definition of relevant activities adequately capture the correct scope of activities, including activities that are part of the monitoring component of internal control frameworks?*

Response

Yes.

21. *Will requiring the auditor to understand whether relevant activities performed by others identified control deficiencies, fraud, or financial statement misstatements improve audit quality?*

Response

Practical application of the reliance on the work of others has required that the audit firms understand the scope of controls being tested, testing methodologies, test results, and identified fraudulent activities. As a result, we don't foresee this requirement having a significant change in audit quality.

22. *Is the principal evidence provision that was in AS No. 2 necessary to adequately address the auditor's responsibilities to obtain sufficient evidence?*

Response

No. The provision to, instead, obtain "sufficient, competent, evidential matter" should adequately address the auditor's responsibility to obtain sufficient evidence, while allowing more reliance on the work of others who are objective and competent.

23. *Does the proposed standard provide an appropriate framework for evaluating the competence and objectivity of the persons performing the testing? Will this framework be sufficient to protect against inappropriate use of the work of others? Will it be too restrictive?*

Response

We believe that the proposed standard may be too restrictive, allowing reliance on Internal Audit and other objective testing groups, rather than providing for the ability to rely on embedded management testing that has been determined to be competent by an independent quality review process. ACE has considered "certifying internal control testers" within the business; however, if greater reliance by the external auditors can not be placed on the results of management testing due to lack of objectivity, these concepts are less attractive. We also believe the scrutiny faced by audit firms in the inspection process serves to limit the inappropriate use of the work of others but may also be causing them to adopt too conservative an approach to relying on the work of others.

24. *Has the Board identified the right factors for assessing competence and objectivity? Are there other factors the auditor should consider?*

Response

Historically, only Internal Audit has been perceived as qualified due to the relative independence provided by their direct reporting to the Audit Committee. Since the initial implementation of the Sarbanes requirements, many companies have created functional roles and compliance-related functions that serve to facilitate their internal attestation process. Although these functions may lack direct reporting to the Audit Committee, they serve as valuable resources in evaluating and reporting on the effectiveness of internal controls. Further description of the functional operations that can provide competent control testing would be helpful. Without a degree of relief in relying on the work of other qualified management personnel, organizations may be required to continue to hire additional Internal Audit staff or engage in external consulting resources at significant expense.

25. *What will be the practical effect of including, as a factor of objectivity, a company's policies addressing compensation arrangements for individuals performing the testing?*

Response

This requirement infers that individuals performing testing would be motivated to obstruct or alter the accurate reporting of internal controls based on their own personal compensation metrics. It should be noted that there is no existing standard that has required auditors to evaluate the compensation requirements and metrics for Internal Audit functions. Therefore, such a requirement suggests that historical reliance on Internal Audit had mistakenly failed to consider this metric. We believe this logic to be flawed. The existing framework for the testing and evaluation of controls provides adequate guidelines to ensure quality assurance with respect to management's testing. Further requiring auditors to examine compensation requirements for management would force auditors to make subjective judgments on the adequacy of the performance planning and compensation process that would be intrusive to companies and require a high degree of subjective evaluation.

5. Recalibrating the Walkthrough Requirements

26. *Will requiring a walkthrough only for all significant processes reduce the number and detail of the walkthroughs performed without impairing audit quality?*

Response

Yes, we believe that eliminating repetitive walkthroughs should minimize business interruption without impairing audit quality. Increased focus on changes in processes and personnel would minimize the risk of impairing the quality of audit efforts and should continue to be the focus of audit planning and assessment of audit risk.

27. *Is it appropriate for the auditor to use others as direct assistance in performing walkthroughs? Should the proposed standard allow the auditor to more broadly use the work of others in performing walkthroughs?*

Response

Auditors should be able to use others as direct assistance when performing walkthroughs and they should be allowed to exercise judgment in determining to what extent they use others. Close alignment of the risk assessment conclusions and areas where walkthroughs would be completed should be an important part of the audit planning process.

C. Scaling the Audit for Smaller Companies

28. *Does the proposed standard on auditing internal control appropriately describe how auditors should scale the audit for the size and complexity of the company?*

Response

As an accelerated filer, this question would not be relevant to our organization.

29. *Are there other attributes of smaller, less-complex companies that the auditor should consider when planning or performing the audit?*

Response

As an accelerated filer, this question would not be relevant to our organization.

30. *Are there other differences related to internal control at smaller, less-complex companies that the Board should include in the discussion of scaling the audit?*

Response

As an accelerated filer, this question would not be relevant to our organization.

31. *Does the discussion of complexity within the section on scalability inappropriately limit the application of the scalability provisions in the proposed standard?*

Response

As an accelerated filer, this question would not be relevant to our organization.

32. *Are the market capitalization and revenue thresholds described in the proposed standard meaningful measures of the size of a company for purposes of planning and performing an audit of internal control?*

Response

No response provided.

D. Simplifying the Requirements

III. Proposed Rule 3525 – Audit Committee Pre-approval of Services Related to Internal Control

33. *Is there other information the auditor should provide the audit committee that would be useful in its pre-approval process for internal control-related services?*

Response

We believe the current reporting and pre-approval procedures are adequate to address the Audit Committee reporting requirements.

VI. Effective Date

34. *How can the Board structure the effective date so as to best minimize disruption to on-going audits, but make the greater flexibility in the proposed standards available as early as possible? What factors should the Board consider in making this decision?*

Response

Audit planning has already been initiated by many organizations. In order to realize the benefits of any aspects of the proposed standard, implementation of the proposed standard at the earliest possible date would be essential. Thus the effective date should be structured to allow, at a minimum, December year-ends (possibly September year-ends) to adopt the new standard in 2007. Auditors can use the proposed standard as a guide to start amending audit strategies now.