THE HARTFORD

November 18, 2003

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

Robert J. Price
Sr. Vice President & Controller

Dear Mr. Secretary:

The Hartford Financial Services Group, Inc. (The Hartford) supports the requirement of the Sarbanes-Oxley Act of 2002 to have management report annually on its assessment of internal controls over financial reporting and we appreciate the opportunity to comment on the draft proposed auditing standard: *An Audit of Internal Control over Financial Reporting Performed in Conjunction with an Audit of Financial Statements* (the "Draft Standard").

We have reviewed the draft standard and the 25 page summary provided by the PCAOB in its Release No. 2003-17 dated October 7, 2003 (hereinafter referred to as "the Summary"). While we support the majority of the concepts in the proposed draft, we believe that a number of the requirements made of the public accountants may have unintended consequences and do not lead to better audits or stronger controls.

Most of the well-publicized audit failures can be attributed to one or more of three conditions: failure of the business, senior management overriding the internal controls, or inappropriate application of accounting principles. Yet the draft audit standard seems to require that public accountants (either directly or by reliance on others) apply the same level of scrutiny to routine processes as they do to higher risk estimation processes or management level controls. One example of this is the proposed requirement to have the public accountants perform walkthroughs of <u>every</u> financial process of any significance, no matter how routine. Another example is the requirement that each year the external auditors must test controls over a "large portion" of locations or business units that are individually not material even when strong company-level monitoring controls are in place and operating effectively.

The scope of work required by management under Sarbanes-Oxley Section 404 is vast and we question whether the PCAOB has a true appreciation for the enormity of work that the external auditors would have if they have to follow the scope of work spelled out in the draft auditing standard. To address the requirements of Sarbanes Oxley Section 404, management of The Hartford is in the process of documenting its significant process and sub-processes, including all key risks and controls over financial reporting. The exponential growth in detail documentation that the Company is developing is significant. While we agree that it is important for the auditor to evaluate this documentation, on a test basis, to help foster an appreciation and understating of the Company's internal control, the sheer volume of documentation also poses a potential risk. Requiring certain detailed procedures or tests presents the risk that the auditors will focus on too many detailed risks without being able to see the "forest from the trees". This could create an environment where the auditors and management are at greater risk of missing important financial reporting matters because of limitation of time and resources and shifting audit or testing focus away from the areas of greatest risk.

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We have responded to a number of questions raised in the PCAOB briefing letter on the draft auditing standard and have listed those questions below by number. Some of our greatest concerns regarding this draft standard are in the area of the nature and scope of testing being required. We have included on comments addressing these concerns at the end of our comment letter in the "General Comments" section.

We would be happy to respond to any further questions you or your Staff may have. You may call me at 860-547-8495.

Robert J. Price
Senior Vice President and Controller

Summary of Key Points

Reliance on management, internal auditors or others

The proposed standard limits the external auditors' ability to rely on internal auditors or management. In particular, we do not agree that the external auditor should be prohibited from using management or internal auditors to perform walkthroughs or test IT general controls.

In the Summary, the PCAOB noted that, "the work that management performs in connection with its assessment can have a significant effect on the nature, timing, and extent of the work the independent auditor will need to perform. The proposed auditing standard would allow the auditor to use, to a reasonable degree, the work performed by others, including management. Thus, the more extensive and reliable management's assessment is, the less extensive and costly the auditor's work will need to be. "

However, the restriction on the use of the work of management or internal auditors significantly impairs the ability of auditors to reduce their workload through reliance on others.

Since reliance on the work of management is a new concept, we suggest that the PCAOB consider developing specific criteria to govern the external auditor's ability to rely on work of management. This guidance should be relatively similar to the guidance espoused by Statement of Auditing Standard No. 65, but should define how the concepts of "objectivity" and "competency" apply to management.

Definition of significant deficiency and material weakness

We disagree with the definition of a significant deficiency as provided in the Draft Standard. The definition provided is overly broad and does not allow for the level of judgment required in such an evaluation.

We disagree that a deficiency in the area of non-routine, non-systematic transactions, and antifraud programs and controls should automatically be considered a significant deficiency. The auditor should evaluate deficiencies in these areas, as with other deficiencies, for the likelihood and magnitude of potential financial misstatements. To limit the auditors' judgment in the area through the use of this "bright line" rule for significant deficiencies can result in an insignificant flaw being reported as a significant deficiency that would be misleading to the readers of the financial statements.

The evaluation of internal control deficiencies is an area of significant auditor judgment. Since management and the auditors are only evaluating significant risks and controls under SOX 404, it would be helpful if the PCAOB gave examples of deficiencies that do <u>not</u> meet the threshold of a significant deficiency.

Extent of testing needed

- Auditors should perform walkthroughs for a sub-set of significant processes, not every significant process. Auditors should be able to validate the effectiveness of controls over all financial assertions relating to a sub-set of processes rather than for every process and sub-process that impacts a significant account. To this point, we feel that the PCAOB should clarify whether control assertions must be tested at the account level or the process level since it can mean the difference between testing a sub-set of the key controls or testing virtually all of the key controls (ie auditing 100%).
- Auditors should not have to perform testing themselves at a "large portion" of field office locations if company-level controls over those locations are strong or if the controls are tested by management, internal auditors or others.

Auditors should not have to test every application control every year unless program change controls are weak.

- In some cases, observation and inquiry alone should be sufficient to test the operating effectiveness of controls. Observation of certain application controls (system edits) is one example.

Responses to Questions Posed by the PCAOB

The Company has considered all of the questions raised by the PCAOB. We have only responded to those questions where we have a comment on the draft wording.

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

Yes, we agree that the external auditor should perform some walkthroughs of key processes. The auditors should perform sufficient testing to be able to draw a conclusion and extrapolate the results of that testing to the overall population. Further they should expand their scope, as necessary, based on their risk assessment and test results. We do not believe that the auditor should be required to perform a walkthrough of "all of the company's significant processes". The theory of auditing is based on the concept of testing samples of data, giving effect to differential expectations of risk, not 100% re-performance. We recommend that the PCAOB consider what is meant by "significant" in this context. If the PCAOB intended the auditor to use a different threshold than management uses for determining which processes are significant, then the PCAOB should make that clear.

Since the auditors are auditing management's assessment of controls and are not opining directly on the internal controls, the auditors should examine both processes and controls on a sample basis. As indicated in the Summary, auditors are not expected to test every single control. Further, paragraph 74 of the Draft Standard indicates that in determining which controls to test, the auditor should select those controls that are most important to achieving the control objective and those controls where there is a greater risk that the control is not operating effectively. We believe that the auditor should be able to apply similar judgment in determining which processes to walkthrough.

To perform management's assessment of internal controls over financial reporting under SOX 404, The Hartford has identified all significant accounts and the processes and sub-processes that generate those account balances and related disclosures. For each sub-process, we have identified control objectives related to every relevant assertion. We have then evaluated the specific risks for each control objective and the key controls in place that mitigate each risk. This is an extremely time consuming and detailed project, with numerous processes, in many cases with multiple sub-processes, and with each sub-process there are a multiple of key controls to address the financial reporting assertions. This exponential growth in detail results in volumes of documentation. While we agree it is important for the auditor to gain an understanding of the Company's internal controls, requiring the auditor to personally perform every walkthrough leads to an undue burden on the auditor, while providing virtually no incremental benefit to the overall audit process.

From our own experience in documenting our significant processes, the auditor would be forced to spend an inappropriately large amount of time performing walkthroughs of all our significant processes. The draft standard makes it clear that a walkthrough is far more than merely inquiring about the accuracy of a flowchart; it requires the auditor to confirm their understanding of the process flows by such procedures as observing the processing of a transaction from start to finish. Although walkthroughs are an important part of any audit, we believe that if auditors have to perform walkthroughs of every process and sub-process, this may divert the auditors' attention away from evaluating controls over the higher risk areas of the company.

If the PCAOB ultimately determines that the auditors are required to perform walkthroughs of every significant process, which we strongly oppose, then given the large volume of significant processes, the auditors must be able to rely to some degree on walkthroughs performed by management, internal auditors or others.

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?

The requirement that the auditor perform walkthroughs themselves, in all cases, is not necessary and does not add to the effectiveness of the audit. We noted that the Summary states, "Because of the judgment that a walkthrough requires and the significance of objectives that walkthroughs allow the auditor to achieve, the proposed auditing standard would require the auditor to perform the walkthroughs himself or herself." We disagree with the idea that all walkthroughs, particularly for many of the routine and certain lower risk non-routine processes, require significant judgment to evaluate. Generally, the objectives of walkthroughs can be obtained more effectively and efficiently by leveraging the work of management or internal audit in the compilation of walkthrough documentation.

As stated in the existing audit standard of due professional care, "gathering and objectively evaluating audit evidence requires the auditor to consider the competency and sufficiency of the evidence." For routine processes and lower-risk non-routine processes, the external auditor should be able to rely on management or internal auditors to perform the walkthroughs as long as management or internal auditors keep sufficient documentation of the process flows and related internal controls.

Further, for the reasons provided in our response to question No. 9, we do not believe it is practical for the auditor to perform walkthroughs of every single significant process themselves.

Even more simply, if the auditor can rely on management, internal auditors or others under certain conditions to test the internal controls (as proscribed under the Draft Standard), then they should also be able to rely on them to perform a portion of the walkthroughs. To exclude the auditor from relying on others to develop the walkthrough documentation is inconsistent with other concepts within the draft standards.

While we believe management or internal auditors should be able to perform some of the walkthroughs, we agree that the external auditors should perform walkthroughs themselves of higher risk areas and should independently validate some of the walkthroughs done by management or internal auditors.

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 no management's assessment?

We agree that the auditor should obtain evidence of the effectiveness of controls for all relevant assertions for all significant accounts every year, but believe this guidance should be clarified in the case of testing of controls at multiple locations or business units and testing IT application controls.

As discussed in our General Response section, we believe that the auditor should be able to test a sample of locations within a group when all locations in the group have the substantially the same processes and controls and the monitoring level controls are operating effectively. Following this approach, the auditor would be testing controls over all relevant assertions for all significant accounts, but would be able to rotate which locations they test each year.

We also believe that if, through some combination of testing by management, internal and external audit teams, the external auditor is able to conclude that a company's IT general controls over release management and access security are operating effectively; neither management nor the external auditor should be required to test every significant application control in the company every year. Effective general controls over the IT environment should provide adequate assurance that the programming logic behind the application controls has not changed, or, even if the logic has changed, that the change had been appropriately tested and that the changes should function as intended. We would support the concept that application controls should be tested on some periodic basis (we would suggest every five years) despite the presence of strong IT general controls over release management and access security since the IT general controls do not specifically address the application control. As a result, we suggest that the PCAOB adopts guidance that provides benefit for having effective general IT controls, and provides further criteria for evaluating the frequently of re-testing application controls within an effective IT general control environment.

12. To what extent should the auditor be permitted or required 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?

We suggest that instead of providing specific areas where the external auditor is either limited or prevented from relying on the work of management or others, the PCAOB should provide additional guidance for reliance on the work of management. The current Statement of Auditing Standard No. 65 "*The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*" provides a good framework to develop similar guidance relating to the use of work of management and others.

We agree with the guidance in paragraph no. 103 of the Draft Standard, which an auditor should apply when evaluating whether they will rely on the work of management, internal audit or others. However, we do not agree with many of the concepts in paragraphs no. 104 and 105, where the PCAOB has set to prevent or limit the external auditors' ability to rely on internal audit or management. The Summary states that "the work management performs in connection with its assessment can have a significant effect on the nature, timing and extent of the work the independent auditor will need to perform. The proposed auditing standard would allow the auditor to use, to a reasonable degree, the work performed by others, including management. Thus, the more extensive and reliable management's assessment is, the less extensive and costly the auditor's work will need to be. " Preventing or significantly limiting reliance on management and internal auditors is inconsistent with the intent expressed in the Summary that allows reliance "to a reasonable degree."

Reliance on the work of others does not mean that the external auditor is prohibited from performing additional procedures. In fact, to the contrary, the current standards require the external auditor to re-perform procedures to develop a level of assurance that the work performed by internal auditors is sufficient for the external auditor to place reliance. SAS No. 65 states, "judgments about assessments of inherent and control risks, the materiality of misstatements, the sufficiency of tests performed, the evaluation of significant accounting estimates, and other matters affecting the auditor's report should always be those of the auditor." We agree that these concepts are appropriate and should also be considered when evaluating the reliance on work performed by management and others.

Specifically, we would like to address certain components of this area of the Draft Standard, including: the concepts of "objectivity" and "competence", areas where reliance on management is limited, and areas where reliance on management is limited.

Requirement of "objectivity" and "competence"
Without additional guidance on what is meant by "objectivity" and "competence", we believe the external auditors would be reluctant to rely on the work of management. While there is professional guidance on when external auditors can rely on internal auditors, the draft standard does not make it clear if those same principles would apply to management. Under SAS 65, external auditors can rely on the work of internal auditors when certain conditions are met. For example, internal auditors must have adequate education and experience, work for individuals who hold professional certifications, receive sufficient training, follow professional auditing standards and remain independent within the organization, just to name a few of the criteria. If those same principles apply to management, very few process owners or control owners throughout the company would meet the standard. If a different standard for objectivity and competence should apply to management, that standard should be made clear.

We believe the PCAOB could define "competency" as being a person who is senior in level and experience to the person who performs the control and who has an adequate understanding of how the process works. We believe that the concept of "objectivity" should apply to the manner in which the employee performs the test, but not to the working relationship of the tester to the person who performs the control. Otherwise, it would be difficult to find people within operations who are competent enough to be a tester of controls but who are divorced from the process itself.

With regard to the areas where the draft standards have provided limitations or restrictions on the external auditor reliance on work of management or others, we have the following comments:

Areas where reliance is prohibited
We agree that it is appropriate for the external auditors themselves to review controls that are part of the control environment and controls over the period-end financial reporting process. However, we do not understand why the external auditors should not be able to use the work of internal auditors in evaluating IT general controls. While we agree that application controls depend on the operating effectiveness of IT general controls, the failure of an IT general control does not typically have the same consequence on the financial statements as a failure in either the controls over the control environment or the controls over the period-end financial reporting process.

Perhaps at issue is what is meant by the term "certain" IT general controls. We are unclear which IT general controls the PCAOB is referring to by this term. The Hartford has over 200 application systems in scope under Sox 404. Even if our external auditor only evaluates controls over a sub-set of that population, it is still a significant amount of work.

Areas where reliance is "limited"
The PCAOB should issue more guidance on when the external auditor can rely on the work of management or others to test controls over non-routine and non-systematic transactions and controls over high risk accounts, processes or disclosures. Based on the wording in the draft standard, we doubt that any external auditor would risk relying on management or internal auditors to test these controls for fear of running afoul of the standard.
When management, internal auditors or others are relied upon to test controls over non-routine and non-systematic transactions or controls over high-risk accounts and processes, the auditor would typically perform substantive audit procedures on the account balances. These substantive procedures help the auditor evaluate the effectiveness of management's testing of key controls in these areas. Therefore, we do not believe that reliance on management, internal auditors or others in these areas should be as "limited" as conveyed in the draft standard.

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?

We do not believe that the proposed standard provides for an appropriate recognition of the work of internal auditors. We believe that the draft auditing standard inappropriately restricts the auditor's use of internal auditors far beyond the restrictions already set forth by SAS 65 "The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements". Under SAS 65, the auditor can rely on internal auditors provided that internal auditors are found to be objective and competent as defined under the standard. SAS 65 does not prohibit use of internal auditors in any specific area, but says that the auditor should consider the materiality, risk and subjectivity of an account balance in determining when to do the audit testing themselves. We do not believe that SOX 404 intended to redefine SAS 65, which has not been the cause of any of the recent financial reporting problems that have occurred.

16. Is the requirement for the auditor to obtain the principal 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?

We agree that the external auditor should validate the work performed by management, internal auditors or others in order to opine on management's assessment of internal controls. We also believe that it should be the auditor's judgment as to how much re-performance of testing they need to do in order to obtain "principal evidence" that the controls are operating effectively, which is consistent with the current draft standard.

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?

The definition of significant deficiency appears unreasonable and inconsistent with previous standards. The Draft Standard defines a significant deficiency as a control deficiency or combination of deficiencies that results in a more than remote likelihood of a more than inconsequential misstatement. This definition appears to be much too all encompassing and does not allow for much latitude when evaluating specific control deficiencies.

We do not believe that control weaknesses over non-routine and nonsystematic transactions should automatically be considered significant deficiencies. The same principles of assessing the likelihood and potential magnitude of a misstatement should be applied when evaluating controls over non-routine and non-systematic transactions. While the inherent risks of a financial misstatement may often be higher with non-routine or non-systematic transactions, this is not always so. For example, the issuance or repayment of debt is a non-routine process, but inherently has very low risk.

We also do not believe that the ineffectiveness of a company's regulatory compliance function should be considered a strong indicator of a material weakness unless related to compliance over financial reporting.

While we agree that an effective compliance function is important, the ineffectiveness of a company's regulatory compliance function should not be considered a material weakness except with respect to laws and regulations which have a material effect on the reliability of financial reporting, such as Regulation S-X.

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?

The examples in Appendix D give insight as to when a significant deficiency should be considered a material weakness, but we believe that more guidance should be given as to when a control deficiency reaches the threshold of a significant deficiency. Implicit in the definition provided in the draft standard is the concept that a control deficiency is not a significant deficiency merely because it relates to a relevant assertion of a significant account. There must also be a more than remote likelihood of a more than inconsequential misstatement. Yet the draft standard also says that the significance of a deficiency depends on the potential for a misstatement, not on whether a misstatement has actually occurred. Since SOX 404 only evaluates controls that reduce the risk of potential misstatement to an acceptable level, it is unclear when a control deficiency would not be considered significant under the draft standard.

The proposed statement on auditing standard, *Communication of Internal Control Related Matters Noted in an Audit,* dated March 18, 2003, defines significant deficiency as an "internal control deficiency that could adversely affect the entity's ability to initiate, record, process and report financial data consistent with the assertions of management in the financial statements". The proposed standard goes on to state that the auditor should consider a number of factors in evaluating whether a deficiency is significant, including the likelihood the deficiency could result in a misstatement, the magnitude of potential misstatements, the importance of the control, the nature of the account balance and the frequency of exceptions. This definition is consistent with earlier definitions of significant deficiency in audit literature, including the definition of reportable conditions under SAS 60.

The PCOAB has significantly changed the definition of "significant deficiency" in issuing the draft auditing standard. While the line may be "brighter" under the newly proposed definition, it is hard to conceive of a deficiency that falls below the threshold of "more than remote" or "more than inconsequential". If so, that would mean that all virtually all deficiencies are "significant" and we question whether that was the PCAOB's intent.

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

We do not believe the effectiveness of a company's regulatory compliance function is relevant except to the extent the company must comply with laws and regulations which have a material effect on the reliability of financial reporting, such as Regulation S-X. The SOX 404 final rule states that, "our definition (of internal control over financial reporting) does not encompass the elements of the COSO Report definition that relate to the effectiveness and efficiency of a company's operations and a company's compliance with applicable laws and regulations, with the exception of compliance with the applicable laws and regulations directly related to the preparation of the financial statements".

The concept identified in SOX 404, is further repeated in the draft standard paragraph that states "internal control over financial reporting does not ordinarily encompass elements related to the effectiveness and efficiency of operations or compliance with laws and regulations. However, operations and compliance with laws and regulations directly related to the presentation of and required disclosures in financial statements are encompassed in internal control over financial reporting." The statement that an ineffective regulatory compliance function is a strong indicator of a material weakness implies that the auditors should be evaluating the regulatory compliance controls, which were previously scoped out of the standard and by SOX 404. For insurance companies, there are a vast array of state-by-state regulations that affect how the company must communicate with policyholders and claimants that have no bearing on the reliability of the financial statements. The effort to evaluate the controls over regulatory compliance would take as much time as evaluating the internal controls over financial reporting. While these controls are definitely important, we do not believe that they are in scope for SOX 404.

General Comments

The company has comments on other portions of the draft standard that do not relate to the specific questions asked by the PCAOB.

Control Testing - Scope

The draft auditing standard requires the auditor obtain evidence about the operating effectiveness of controls for all relevant assertions for all significant accounts and disclosures. However, the draft standard is not clear whether the auditor needs to evaluate the controls at a <u>process</u> level or at a significant <u>account</u> level. To illustrate the confusion, we will use premium processing for our property and casualty operations as an example.

We have 19 property and casualty business units that generate written premium. Four of the 19 account for 68% of the written premium (based on 2002 calendar year data). The other 15 business units range from 1% to 8% of the total, where each of the 15 is at least 2 to 3 times our materiality threshold of $35 million. Accordingly, all 18 business units are "individually financially significant" to use a term in the draft auditing standard. Each of the 15 smaller businesses market different products and have unique processes.

If the auditor interprets your draft guidelines to mean that a walkthrough and test of controls is required at the process level, then all of the premium financial statement assertions need to be tested for all sub-processes within each of the 19 business units because every sub-process is "significant". If, however, control testing is required at the significant account level, the auditor could test relevant assertions over written premium for the four largest business units plus a portion of the remaining 15 business units. We believe the latter approach is more reasonable. As with a financial statement audit, we do not believe the auditor should have to test 100% of an account balance to gain audit-level assurance.

We believe it is more appropriate that the auditor test control assertions at the account level than the process level. If the auditor, like management, is required to test controls over relevant assertions for every significant process, the auditor would be required to test nearly all of the controls. Management's scope of testing and the auditor's scope of testing would only differ to the extent that the auditor determines that some of the specific risks related to a particular financial statement assertion or control objective are not that important. We do not believe that an audit of management's assertion should require the auditor to test nearly every control, and we think that the scope difference between management and the auditor needs to be more clearly defined within the standards.

Nature of Testing

We also believe that in some cases observation and inquiry alone can be a sufficient test of operating effectiveness of controls. Paragraph 89 says that because observation is pertinent only at a point in time, the auditor should supplement the observation with inspection of documentation about the operation of such controls at other times. However, we believe that there are some instances where observation should be considered sufficient testing of operating effectiveness, particularly for application controls.

An example is a test of a transaction edit that prevents an employee from processing a payment in excess of a certain dollar amount. In this case, we believe that it would be sufficient for the auditor to observe the employee trying to process a payment in excess of the threshold, provided that the auditor also tested program change controls over the application.

Scope of Testing – Multiple Locations

We are concerned that the discussion in Appendix B on tests to be performed when a company has multiple locations or business units is unclear on whether the auditor can rely on testing at various locations performed by management, internal auditors or others. This is an important clarification since frequently field office locations process a significant portion of a company's routine transactions which is, under the current draft standards, the one area where the external auditor is generally permitted to use management, internal auditors or others to do testing.

If it is true that the external auditor has to perform testing for a "large portion" of field locations, we believe the external auditor should be able to rely on testing done by management or others to fulfill this responsibility. Under SAS 65, "if the internal auditors' plan includes relevant audit work at various locations, the auditor may coordinate work with the internal auditors and reduce the number of the entity's locations at which the auditor would otherwise need to perform auditing procedures".

The Hartford's property and casualty operations have 15 regional offices throughout the country that generate written premium for our small commercial, middle market and marine businesses. Each of the 15 regional offices accounts for at least 2% of the total written premium for those businesses and no one regional office accounts for more than 16% of the total. However, every regional office uses the same systems, has the same processes and controls and is subject to the same monitoring level or "company level" controls as that term is used in Appendix B.

Paragraph B11 of Appendix B states that testing company-level controls is not a substitute for the auditor's testing of controls over a "large portion" of the company's operations or financial position. This guidance fails to recognize that a process that is performed in different locations can be as tightly controlled as when that same process is performed at one location. Appendix B does not allow the external auditor to select a relatively small number of locations or business units even if the "company level" supervisory controls are as strong as they would be if all of the operations were centralized in one location. We believe the PCAOB should re-consider this guidance.

Paragraph B4 of the draft standard makes the statement that "generally, a relatively small number of locations or business units will encompass a large portion of a company's operations and financial position…." This is not always the case. Companies in the insurance industry, for example, typically have a significant number of field locations that underwrite and process claims. Furthermore, we believe that there are many companies in other industries which have either many locations or many business units that account for a significant share of their business.

Furthermore, paragraph B11 of Appendix B provides guidance which conflicts with the language in paragraph B2. Paragraph B2 says that when there are a group of locations that aggregate to a material amount, the auditor should either test company-level controls or perform tests of controls at some of the locations or business units. We agree with the concept in paragraph B2 which implies that the auditor could test controls at a relatively small number of locations as long as they found company-level controls to be working effectively. Paragraph B11, however, seems to prevent the auditor from relying on company-level controls to reduce the extent of their testing. That doesn't make sense to us.

We believe that the auditors can test controls for all relevant assertions for all significant accounts without having to visit a large portion of field offices as long as the field offices have substantially the same processes and controls and are subject to the same monitoring level or company level controls.

Integration and Coordination of Financial Statement Audit and Audit of Internal Controls

The Draft Standard does not specifically address the efficiencies that can be gained through coordinating the efforts of the financial statement audit and those of the audit of internal controls over financial reporting. Without clearly addressing how these two audits are integrally linked, there is a significant risk of excessive cost and wasted effort, with little if any incremental benefit to the investing public and financial statement users. In many instances, an auditor would be able to more efficiently test and validate balances on the income statement or balance sheet without analyzing all of the processes, sub-processes and related internal controls that brought the Company to reporting that balance. In cases where an auditor can more effectively validate a financial statement balance, a reasonable person could also infer that the internal controls had functioned appropriately to support that balance without having to test all of the internal controls. We suggest that the PCAOB specifically address the integration and coordination of the audits of the financial statements and internal control in the Draft Standard. Providing additional guidance in this area will help mitigate the costs of this effort, which is good for the investing public, while providing a consistent level of assurance on a Company's financial reporting processes.

Utilization of Service Auditors' Reports

In section B36 of the Draft Standard, the PCAOB appears to require what is potentially a significant amount of audit work to be performed by management and the external auditors of a Company utilizing service providers, who have SAS 70 reports for periods less than the entire fiscal year covered by management's assertion and the related audit opinion. We believe that a service provider SAS 70 report that; covers an entire year, and either ends on the day before the current fiscal year or some partial period of the current fiscal year, management of the user company should be able to rely on the results of the previous SAS 70 report, as long as management supplements this understanding with inquiries of the service provider company management. We believe that the inquiries of service provider company management should be focused on confirming that a SAS 70 is in process for the current period and asking management to provide negative assurance to the effect that they are not aware of any significant changes in the control environment or effectiveness of the Company's overall internal control that would warrant a significant change to the prior SAS 70 report, including the controls identified and the auditors opinion. Requiring additional independent testing and evaluation by user organizations for SAS 70 reports that do not cover the entire current fiscal year does not appropriately consider the timing delay in issuing SAS 70 reports and results in duplication and wasted audit efforts. These requirements are inconsistent with the intent of SAS 70 reports, which were meant to eliminate the need for user organizations to have to perform their own independent evaluation of the service providers internal control.

We believe that the service providers and audit profession will begin to address the PCAOB's concept of more "fresh" SAS 70 reports by changing the SAS 70 reporting and testing period and/or providing multiple reports per year (either quarterly or semi-annually), or even developing guidance for external auditors to provide for "negative assurance" for interim periods not covered by issued SAS 70 reports. Since these developments have not yet taken place, we would, at a minimum suggest that the PCAOB provide ~~some~~ transitional guidance for the use and reliance on SAS 70 reports. We strongly urge the PCAOB to eliminate requirements resulting in potentially unnecessary work for user organizations (or by their external auditors) related to delays in timing of audit report issuance, particularly where such work does NOT provide any substantial increase in assurance on the effectiveness of internal controls.