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

RE: PCAOB Rulemaking Docket Matter No. 008

Dear Board Members:

I commend the Public Company Accounting Oversight Board's for the research and effort that has been put into the proposed auditing standard, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements*, and appreciate the opportunity to comment on the proposed standard. The proposed standard was issued pursuant to Section 404 of the Sarbanes-Oxley Act of 2002 (the "Act").

Our Firm provides representation in securities and corporate governance matters to private and public companies, including "issuers" under the Act. I have had informal discussions regarding the comments below with several issuers, including several large public companies that are not clients of our firm. In addition, I personally am a non-practicing CPA and have experience as an auditor and as a corporate controller, so I have some experience in internal control issues.

(On a personal note, I should mention that I attended Mr. McDonough's presentation last night at the Georgia Society of CPAs dinner; I enjoyed his remarks and appreciated his taking the time to visit us in Atlanta.)

We believe that shareholders are benefited most when there is a proper balance between the benefits of improvements in controls and disclosure on the one hand, and the costs of those improvements on the other. Also, it is important for the process to be efficient and avoid undue duplication of effort. While the PCAOB proposed standard does a good job of giving a framework for internal control, it does not strike the proper balance of costs versus benefits. In addition, we believe that the standard should be more principles-based in giving guidance rather than specific rules. The attached comments are directed toward achieving a better balance.

Sincerely,

ARNALL GOLDEN GREGORY LLP

Robert F. Dow

RFD:dsl

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PCAOB Comments

Questions regarding an integrated audit of the financial statements and internal control over financial reporting:

1. *Is it appropriate to refer to the auditor's attestation of management's assessment of the effectiveness of internal control over financial reporting as the audit of internal control over financial reporting?*

Response:

No, we don't think this terminology is appropriate for two reasons. First, it is not consistent with the terms used in Section 404 of the Act. Second, the term "audit" has come to have a very specific meaning in the accounting literature as it relates to the audit of financial statements. We think using this term for the review of internal controls will cause confusion, thereto, possibly misleading investors as to the level of assurance that can be given to the attestation of internal controls. A higher level of assurance inherently can be given as to financial statements which speak only as of a past date. Although companies will review the internal controls as of a past date, by the nature of the review you are trying to give assurance regarding a system and its capacity to prevent misstatements in the future. This will always engender a lower level of assurance no matter how much work is put into it.

2. *Should the auditor be prohibited from performing an audit of internal control over financial reporting without also performing an audit of the financial statements?*

Response:

Yes. An audit of the financial statements provides unique insight into the internal controls.

3. *Rather than requiring the auditor to also complete an audit of the financial statements, would an appropriate alternative be to require the auditor to perform work with regard to the financial statements comparable to that required to complete the financial statement audit?*

Response:

No. The review should be part of the audit engagement, as specified in the Act.

Questions regarding the costs and benefits of internal control:

4. *Does the Board's proposed standard give appropriate consideration to how internal control is implemented in, and how the audit of internal control over financial reporting should be conducted at, small and medium-sized issuers?*

Response:

In the portions of the standard that address documentation, there should be an acknowledgement that smaller companies may have different levels of controls with many different levels of documentation, and that this is acceptable provided that the auditor can be satisfied that the general controls and closer review by management sufficiently compensate for the lack of other formal controls. This is one of the areas where the costs and benefits should be given special consideration.

Question regarding the audit of internal control over financial reporting:

5. *Should the Board, generally or in this proposed standard, specify the level of competence and training of the audit personnel that is necessary to perform specified auditing procedures effectively? For example, it would be inappropriate for a new, inexperienced auditor to have primary responsibility for conducting interviews of a company's senior management about possible fraud.*

Response:

No, this should be left to the judgment of the auditor.

Questions regarding evaluation of management's assessment:

6. *Is the scope of the audit appropriate in that it requires the auditor to both evaluate management's assessment and obtain, directly, evidence about whether internal control over financial reporting is effective?*

Response:

Yes, the auditor should obtain some level of direct evidence. However, the auditor should be permitted to rely on the work of others to provide a large portion of the evidence.

7. *Is it appropriate that the Board has provided criteria that auditors should use to evaluate the adequacy of management's documentation?*

Response:

Yes.

8. *Is it appropriate to state that inadequate documentation is an internal control deficiency, the severity of which the auditor should evaluate? Or should inadequate documentation automatically rise to the level of significant deficiency or material weakness in internal control?*

Response:

It is appropriate to have the auditor evaluate the severity. There will likely be varying degrees of documentation among companies and it would be difficult to draw a simple bright line rule that articulates the appropriate level of documentation in all cases.

Questions regarding obtaining an understanding of internal control over financial reporting:

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

Response:

Walkthroughs are an effective way for the auditor to learn the client's system and evaluate it. However, it is not necessary for the auditor to repeat the walkthrough every year. Once the auditor has performed a walkthrough for a significant process, in subsequent years the auditor should be permitted to rely on a combination of prior years' walkthroughs, inquiry of management that indicates no material change, and the results of testing which are consistent with management representations.

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?*

Response:

The auditor needs to perform the initial walk-through himself or herself. However, the auditor should be allowed to use the work of others to assist in the walk-through, e.g., review flow charts prepared by internal audit. Also, as noted in No. 9 above, it may not be necessary for the auditor to perform the walk-through every year. The auditor should be allowed to rely on the work of others to decide it is not necessary to re-perform a walk-through in a subsequent year.

Question regarding testing operating effectiveness:

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 on management's assessment?*

Response:

The auditor should obtain some evidence each year, but should be able to rely on prior years' work to reduce the amount of testing in the current year.

Questions regarding using the work of management and others:

12. *To what extent should the auditor be permitted or required to use the work of management and others?*

Response:

The auditor should be permitted and encouraged to make careful use of the work of management and internal auditors, to make sure the process is more efficient. The key is for the auditor to make an initial assessment of the objectivity and competence of the personnel performing the work. The auditor then should make selective use of the results of re-testing and the auditor's own testing to validate the conclusions.

13. *Are the three categories of controls and the extent to which the auditor may rely on the work of others appropriately defined?*

Response:

The Board should re-craft these categories in the form of guidance for the auditor to consider in deciding the extent to use the work of others, rather than making mandatory categories. This would represent a better principles-based approach, and would lead to a more efficient process.

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?*

Response:

No. Because of the proposed standard's emphasis on having the independent auditor himself or herself provide the principal source of evidence, the role of the internal auditor will be minimized. The independent auditor should be allowed to place a higher degree of reliance on internal auditor's work than is suggested by the current proposal.

However, we do agree with the general tone of the proposed standard, which suggests that the auditor can place a greater degree of reliance on the work of an objective and competent internal auditor than on other sources.

The IIA standards, while helpful, should not be the exclusive source of guidance. The auditor should be permitted to make his/her own assessment by re-testing the internal auditor's work and reviewing the internal auditor's reports to the audit committee.

15. *Is the flexibility in determining the extent of reperformance of the work of others appropriate, or should the auditor be specifically required to reperform a certain level of work (for example, reperform tests of all significant accounts or reperform every test performed by others that the auditor intends to use)?*

Response:

There should not be a specified level of work. This will vary from engagement to engagement based on the company's risk profile, and the competence and integrity of the company personnel performing the work for management.

16. *Is the requirement for the auditor to obtain the principle 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?*

Response:

No. See responses to Nos. 12, 13 and 15 above. The auditor should always obtain some independent work, but may in some circumstances use the work of management and internal audit as the majority of its evidence. This determination would turn on two major considerations: (1) an overall risk assessment of the company's control environment, and (2) an assessment of the objectivity and competence of the personnel performing the work.

Questions regarding evaluating results:

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?*

Response:

The definitions are difficult to apply because of the problems in determining "remote." This definition has been difficult to apply even under SFAS No. 5. In addition, there is no definition of "inconsequential" which becomes an important concept in the proposed standard. Remote and inconsequential create too low of a threshold when combined with the requirement that a single material weakness results in an adverse opinion. This combination will lead to heated debates about the remoteness of the likelihood of errors and will create the temptation to be inconsistent with the definitions of remote and inconsequential. This will make consistency unlikely (or "remote").

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?*

Response:

The examples are helpful. Please consider adding additional examples in the future.

19. *Is it necessary for the auditor to evaluate the severity of all identified internal control deficiencies?*

Response:

Yes. This is one of the most important steps in this process by the auditor and also the area that requires the greatest level of professional judgment.

20. *Is it appropriate to require the auditor to communicate all internal control deficiencies (not just material weaknesses and significant deficiencies) to management in writing?*

Response:

Yes, all deficiencies should be communicated to management in writing. This serves to better document the work performed and to put management on notice of the deficiencies. Management's response represents an important factor in evaluating the control environment.

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

Response:

See comments 22 and 23 below re: audit committees. Otherwise, the matters listed by the board appear appropriate.

22. *Is it appropriate to require the auditors to evaluate the effectiveness of the audit committee's oversight of the company's external financial reporting and internal control over financial reporting?*

Response:

The auditor should evaluate the role of the audit committee as part of its overall assessment of the control environment. In most cases, the auditor should not give a pass/fail type grade on the committee. To ask the auditor to do so may do harm to the important relationship between the auditor and the committee. There may be some extreme cases, e.g., a committee that has no meetings at all, where the auditor may conclude that there is a totally ineffective committee.

23. *Will auditors be able to effectively carry out their responsibility to evaluate the effectiveness of the audit committee's oversight?*

Response:

See response to No. 22 above. The auditor should include the audit committee as part of its overall assessment of the control environment. To require the auditor to make a separate pass/fail assessment of the committee will put too much strain on the relationship. Also, because the committee hires the auditor and serves as the auditor's overseer it will be difficult for the auditor to give an objective and frank assessment on a stand-alone basis.

24. *If the auditor concludes that ineffective audit committee oversight is a material weakness, rather than require the auditor to issue an adverse opinion with regard to the effectiveness of the internal control over financial reporting, should the standard require the auditor to withdraw from the engagement?*

Response:

Definitely not. The auditor should remain engaged and report its findings. This will better serve the shareholders than forcing the auditor to withdraw. In most cases, an ineffective audit committee would not make it impossible to do an evaluation and a report on internal control, although it would likely lead to some qualification of that report.

Questions regarding forming an opinion and reporting:

25. *Is it appropriate that the existence of a material weakness would require the auditor to express an adverse conclusion about the effectiveness of the company's internal control over financial reporting, consistent with the required reporting model for management?*

Response:

No. The auditor should be permitted to issue an "except for" qualified report in instances where there is an isolated material weakness and there have been no errors or irregularities in the financial statements. However, in most cases the auditor would issue an adverse opinion.

26. *Are there circumstances where a qualified "except for" conclusion would be appropriate?*

Response:

Yes. See No. 25 above.

27. *Do you agree with the position that when the auditor issues a non-standard opinion, such as an adverse opinion, that the auditor's opinion should speak directly to the effectiveness of the internal control over financial reporting rather than to whether management's assessment is fairly stated?*

Response:

Questions regarding auditor independence:

28. *Should the Board provide specific guidance on independence and internal control-related non-audit services in the context of this proposed standard?*

Response:

The Board should give more guidance in this area, and change the tone or the rhetoric to move toward finding acceptable ways for the auditors to help management make the internal control environment more effective and the control assessment process more efficient. Everyone understands that the auditor cannot design the controls that he/she then has to evaluate, but that does not mean that the auditor cannot give guidance and educate management without impairing independence. Give more examples of acceptable ways for auditors to do this.

29. *Are there any specific internal control-related non-audit services the auditor should be prohibited from providing to an audit client?*

Response:

SEC rules already preclude the independent auditor from designing controls or acting as internal auditor. That is sufficient.

Questions regarding auditor's responsibilities with regard to management's certifications:

30. *Are the auditor's differing levels of responsibility as they relate to management's quarterly certifications versus the annual (fourth quarter) certification, appropriate?*

Response:

Yes. The auditor does not have a duty to report at quarter end, nor should one be added. However, the auditor should not continue the engagement if he/she is aware of misleading disclosures about controls.

31. *Is the scope of the auditor's responsibility for quarterly disclosures about the internal control over financial reporting appropriate?*

Response:

Yes.