November 21, 2003

RE: PCAOB Rulemaking Docket Matter No. 008

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

Dear Sir or Madam:

We have reviewed the guidance issued by the Public Company Accounting Oversight Board, "Proposed Auditing Standards – An Audit of Internal Control over Financial Reporting Performed in Conjunction with an Audit of Financial Statements." The Home Depot would like to comment on a few select areas.

Question 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?

Comment: The auditor should be prohibited from performing an audit of internal control over financial reporting without also performing an audit of the financial statements. Auditors obtain significant knowledge of a company through financial statement audits and such knowledge should be leveraged to assist auditors in their conclusions regarding effectiveness of internal controls. We believe it would be difficult to adequately understand a company's internal controls over financial reporting without understanding the financial statements and the relationship between the financial statements and the controls that affect them.

The proposed standard does not provide guidance about the interaction of the audit of internal controls and the financial statement audit. There appears to be a narrowing gap between the internal control related objectives of these two audits and we recommend the Board provide more specific guidance pertaining to the interaction between these two audits.

Question 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?

Comment: An alternative requiring the auditor to perform work comparable to a financial statement audit to support an audit of internal controls would not be appropriate. The audit of internal controls should be included in the audit engagement as specified in the Sarbanes-Oxley Act ("the Act"). The additional cost of the work performed to obtain the audit of internal control over financial reporting would not provide a substantial benefit to the shareholders.

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

Comment: It is appropriate for the Board to provide criteria that the auditors should use to evaluate the adequacy of management's documentation. The extent and type of documentation required should not be left solely to the discretion of the auditors. Providing criteria will enhance the consistency of documentation amongst all companies as well as enhancing the consistency of the auditors' evaluation of these companies.

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

Comment: Based on the objectives noted in the proposed standard, we agree that walkthroughs should be required. We believe that walkthroughs validate the company's documentation of the process.

We strongly recommend however, that the Board consider adjusting the proposed standard to permit substituting classes of transactions for individual transactions (e.g. batch transactions). The proposed standard speaks to individual transactions only.

Question 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?

Comment: We agree with the Board in its requirement that auditors perform walkthroughs. However, the proposed standard could provide additional guidance for auditors related to (1) relying on walkthroughs performed by the company, (2) relying on prior year walkthroughs, and (3) the extent of walkthroughs required to be performed.

The Home Depot believes the auditor should be allowed to rely on the walkthroughs performed by the company, including management and/or internal audit. We propose that the auditor re-perform or review a sample of the walkthroughs documented by the company. This is consistent with the Board's proposed standard regarding the Use of the Work of Management and Others. We also suggest that the Board consider concurrent walkthroughs that are performed by the auditors and the company.

Auditors should be required to perform independent walkthroughs for significant processes and for any significant new processes after the first year. For all other processes, the Board should consider allowing the auditors to rely on prior year walkthroughs, as long as they confirm that no significant changes to the process have occurred.

Question 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?

Comment: The auditor should be allowed to use evidence obtained in previous years. We understand there are instances when prior year evidence is not sufficient and those should be clearly defined in the proposed standard. Such instances include: (1) instances of significant changes to previous year processes and/or controls (2) new processes and/or new controls implemented during the year or (3) any time there is a change in senior financial management. We feel that requiring them to perform the same tests year over year on processes that do not change is not cost beneficial to the company nor does it provide an increased level of assurance to management or our shareholders.

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

Comment: We believe that the extent of the work to be relied upon should be based on the competence and independence of the individuals of the company performing the work and on the significance of the process. Allowing additional reliance on the work of others will ensure compliance with the Act is cost effective without jeopardizing the auditor's evaluation. Further, the auditor should then selectively use the results of re-performance in addition to the auditor's own testing to formulate the conclusion on the effectiveness of internal controls.

<u>Question 13 - Are the three categories of controls and the extent to which the auditor may rely on the work of others appropriately defined?</u>

Comment: The proposed standard clearly defines three categories of control, including examples, and the extent to which the auditor may rely upon the work of others for each of these categories. Both general IT controls and application IT controls are a significant part of the internal controls of the company. The Board should add specific language to the standard to address when the auditor may rely upon the work of management and others pertaining to IT control testing. We believe there are instances in which the auditor could rely on the IT control testing performed by management and others.

<u>Question 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?</u>

Comment: We do not believe there is appropriate recognition of the work of Internal Audit. In today's environment and due to recent rulemaking, Internal Audit departments are more independent than ever. In addition, as part of the company, Internal Audit departments typically have visibility to many areas of the company, the opportunity to interact with management more frequently, and a significant understanding of company processes and controls across all functions. It is our belief that due to Internal Audit's in-depth knowledge of the business combined with their independence, the work they perform should be considered reliable and the auditors should be encouraged to rely on their work.

<u>Question 15 - Is the flexibility in determining the extent of re-performance of the work of others appropriate, or should the auditor be specifically required to re-perform a certain level of work (for example, re-perform tests of all significant accounts or re-perform every test performed by others that the auditor intends to use)?</u>

Comment: The standard should allow the auditors to exercise judgment and thereby provide guidance rather than specific rules. The flexibility currently specified in the proposed standard in determining the extent of re-performance of the work of others is appropriate. The amount of reperformance will vary from company to company and should be determined based on the auditor's risk assessment of the company and its management.

<u>Question 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?</u>

Comment: We find that the definitions in the proposed standard of significant deficiency and material weakness do not provide for increased consistency in the evaluation of deficiencies. We strongly suggest that the Board expand the discussion around what constitutes a remote likelihood and a material misstatement. Moreover, we suggest that the Board provide specific examples as to how to measure potential misstatement. Such a measurement will prompt additional discussions between management and the auditors in determining if such a misstatement is "more than slight" in addition to determining if its potential magnitude is "more than inconsequential." These definitions are vague in nature and are largely dependent on professional judgment and skepticism. Without further clarification, such judgement will lead to widespread interpretation and inconsistent application.

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

Comment: We believe that it is necessary for the auditor to evaluate the severity of all identified internal control deficiencies when determining their overall conclusion on the effectiveness of internal controls. We strongly believe that each deficiency should not be measured to carry equal weight in the determination as to whether a material weakness exists. Rather, the severity of each should be judged individually and then in conjunction with other deficiencies. We suggest that the Board provide examples further defining when a significant deficiency results in a material weakness.

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

Comment: We suggest that in areas that are highly judgmental and subjective in nature, such as the use of estimates, the board allow auditors the ability to exercise judgement in determining whether a misstatement resulted from an audit. We also believe the standard needs greater definition of what constitutes an ineffective internal audit function.

Finally, valid reasons may exist for not correcting significant deficiencies communicated to management in a timely manner. As such, the auditor's focus should not be on if the items have been corrected, but rather how the company has addressed the issues. There may be valid reasons why certain deficiencies may require significant amounts of time to correct.

Question 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?

Comment: We believe it is not appropriate to require the auditors to evaluate the effectiveness of the audit committee regarding financial reporting. Such oversight removes independence between the audit committee, which hires, fires, and compensates the auditor. Generally, if the audit firm were to disagree with the audit committee's effectiveness, the auditor would take corrective action.

Question 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?

Comment: We do not believe it would be appropriate to require the auditor to withdraw from the engagement. The auditor should complete the audit and issue the audit opinion. Staying engaged would provide greater protection to shareholders. Furthermore, an ineffective audit committee does not prevent the completion of the audit and evaluation on the internal control over financial reporting.

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

Comment: The differing levels of responsibility between annual and quarterly reporting is appropriate as the auditor does not have a responsibility to report on their audit of internal controls on a quarterly basis. Parallel to the auditor's current quarterly requirements, it is appropriate for the auditor to perform limited procedures each quarter to determine if there are any material modifications to the disclosures of internal controls. Further, if during the course of a quarterly review, the auditor becomes aware of misconduct, the auditor should bring the matter to the attention of management and the audit committee and if necessary consider withdrawing from the engagement.

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

Comment: We believe that the scope is appropriate and that no measurable benefit would arise from increased responsibility on a quarterly basis.

Very truly yours,

/s/ Carol Tomé

Carol Tomé, Executive Vice President and Chief Financial Officer
The Home Depot