Harsco

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November 21, 2003

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

Ladies and Gentlemen:

Harsco Corporation appreciates the invitation to comment on the proposed auditing standard. Harsco is a diversified, $2 billion industrial services and engineered products company with operations in over 40 countries.

Harsco Corporation supports the Board's objective to establish a consistent standard for evaluating management's assessment of the internal controls over financial reporting and recognizes the need for such guidance due to the fact that the audit requirements are substantially different from the traditional financial statement audit. We are, however, concerned that the compliance costs associated with the proposed standard, both in terms of external audit fees and internal expenses, will be excessive. Harsco is comprised of a diverse group of businesses in approximately 400 locations, many of which are not individually significant but are separate reporting units. The company historically has a strong internal control culture and framework. The requirements of this standard, specifically the level of detail testing to be performed by the external auditors, will result in significantly higher external audit fees.

The following comments more specifically outline our concerns over the proposed Auditing Standard, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements*. Our responses are arranged to correspond with the thirty-one questions provided in the Summary Section of PCAOB Release No. 2003-017, however, we have only responded to those questions for which we have a comment.

Question 5: *Should the Board, generally or in this proposed standard, specify the level of competence and training of audit personnel that is necessary to perform specified auditing procedures effectively?*

This proposed standard should not specify the level of competence and training of audit personnel. An evaluation of the competence of audit personnel should be accomplished through separate standards applied to the external auditing profession as a whole. Setting specific guidelines in this standard may result in unnecessary increases in external audit fees.

Question 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?*

The overall scope of the audit standard appears appropriate; however, we have the following specific concerns relating to definitions provided in the standard. First, the requirement in paragraph 57 that the auditor evaluate the audit committee's *level of involvement and interaction with the independent auditor, including the committee's role in the appointment, retention, and compensation of the independent auditor* is an inherent conflict of interest. The definition should be modified to be more specific about the auditor's responsibility and to reduce the subjective nature of the evaluation. For example, to address whether the committee is adequately involved in the appointment and retention process, the auditor could determine that the audit committee formally approved the fees and conducted interviews with the external audit firm.

Secondly, the definition in paragraph 61 could easily be construed to include every balance in the financial statements. This current definition is too broad in stating that the misstatements should be considered significant if they could be material when aggregated with others. It would be difficult, if not impossible, to exclude any accounts based on this criteria. The standard should be revised to require a materiality assessment similar to the requirements in a traditional financial statement audit.

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

We believe that it is appropriate to include such criteria. However, the standard currently does not emphasize that the documentation criteria listed in paragraph 43 should be considered in the context of the overall control environment and management's understanding of the relevant business processes. For example, company management may be able to gain comfort over a relevant cycle through a combination of documentation forms such as control questionnaires, division policies, desk procedures and job descriptions, because of their general understanding of the business and related risks. The standard should expand on paragraph 44 to clearly state that multiple forms of documentation, even over the same relevant business cycle, may be sufficient. Requiring companies to consolidate all of the relevant items in the criteria into one all encompassing form of documentation is not justified.

Question 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?*

Inadequate documentation should be considered an internal control deficiency but should not automatically rise to the level of significant deficiency or material weakness. In a diverse entity with many divisions and reportable entities, the significance of inadequate documentation must be evaluated in combination with many other factors. Examples include the overall control environment, management's involvement and understanding of the business, the results of internal control and financial statement audit testing, etc.

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?*

The performance of walkthroughs are a key step in gaining an understanding of the controls in place over a relevant business cycle. However, the fact that the auditors may only place reliance on the walkthroughs they perform themselves is very restrictive. At a minimum, walkthrough documentation performed by an effective internal audit department and reviewed by external auditors should provide a level of additional assurance and be considered part of the overall testing coverage. The benefit of allowing some limited reliance is that in many cases, internal audit has a better understanding of the company's systems and can more efficiently and effectively perform and document walkthroughs. The external auditor should still be expected to review the walkthrough documentation in the same manner that they would review their own staff's work.

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?*

Similar to the approach used in the financial statement audit, the auditor should be expected to obtain assurance over key account balances and disclosures on an annual basis. The difficulty in applying this standard to the evaluation of the effectiveness over internal control is that many entities have very diverse operations with numerous divisions which are not material to the financial statements as a whole. Requiring the auditor to evaluate each year independent of previous efforts would exclude the auditor from gaining some level of assurance from periodic visits to smaller locations. It would also require the auditor to focus only on the most significant locations each year in an attempt to get to the necessary coverage while not reviewing smaller entities where the risk of errors or fraud could be higher.

Initial feedback from the external audit firms seems to indicate that their focus will be on quantitative annual coverage, including management's testing coverage. We are concerned that the internal audit plan and other management testing plans may have to be modified to achieve this quantitative coverage annually at the expense of focusing on locations where, regardless of size, the perceived or qualitative risk is higher. Allowing for some assurance to be gained from prior year work should help alleviate this pressure.

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

As noted in our response to question 10, the standard should allow additional work performed by an effective internal audit function to be relied upon to some degree. The level of this assistance and the evaluation of the internal audit function should closely resemble the guidelines in AU sec. 322 (The Auditor's Consideration of the Internal Audit Function in the Audit of Financial Statements).

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

The guidance provided in paragraph 104 regarding those controls where the auditor should not use the results of testing performed by management should be clarified. Specifically, the description of controls over the period-end financial reporting processes identifies controls to initiate, record and process journal entries in the general ledger; and to record recurring and nonrecurring adjustments to the financial statements. This definition is too broad and should be narrowed to focus on journal entries, report combinations and reclassifications at the Corporate and/or Business Segment level. The current definition may restrict the auditor from relying on internal audit work at remote locations and smaller entities which may not receive external audit attention but where the testing performed by management at these locations could provide some level of assurance regarding the overall control environment of the company.

Further, the definition of *certain information technology general controls* should be clarified to provide specific examples of those types of controls that the standard intends to address.

Question 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?*

The external auditor should be required to evaluate the extent of reperformance on a case-by-case basis based on their assessment of the entity performing the test (i.e., management, internal audit, etc.). The current standards over the external audit profession adequately address this issue.

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?*

The definition of significant deficiency as proposed is not adequate to increase consistency in the evaluation process. The definition of the terms *more than a remote likelihood* and *more than inconsequential in amount* are not sufficient and may result in a wide range of interpretations. The examples provided in Appendix D draw conclusions that items are significant deficiencies without any quantitative consideration. Similar to our response to Question 6, the definition of significant deficiency is vague and will make it difficult for any identified control exception to not be considered a significant deficiency.

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

Yes, the severity of each deficiency needs to be considered in order to form an opinion on the overall assessment of the effectiveness of internal control.

Question 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?*

Yes, all items which are determined to be internal control deficiencies should be reported to the audit committee in a manner similar to the traditional financial statement audit management letter. This process will provide key feedback to management in their continuing efforts to strengthen the internal control environment within the organization.

Additional Comments:

Requirement for Written Representations:

The standard defines certain required written representations from management that the auditor must obtain in paragraph 128. Part F requires that management must *state whether previously identified internal control deficiencies have been resolved, and specifically identifying those that have not*. This should be modified to require representation only as it pertains to those deficiencies classified as significant. The internal control environment within any organization is continually evolving and a requirement to represent to all deficiencies, regardless of significance is not practical.

Respectfully Submitted,

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Via Electronic Mail