November 21, 2003

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

Reference: PCAOB Rulemaking Docket Matter No. 008

Proposed Auditing Standard – An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements

Ladies and Gentlemen:

Bank One Corporation ("Bank One") is pleased to have the opportunity to comment on the above referenced Proposed Auditing Standard ("Proposed Standard"). Bank One is the nation's sixth-largest bank holding company, with assets of more than $299 billion.

Bank One supports the general theme of the Proposed Standard, which requires the external auditor to take additional responsibility in evaluating the effectiveness of internal control over financial reporting. However, Bank One has two primary comments regarding specific tenets of the Proposed Standard and three additional comments where we believe the proposed guidance is either unnecessarily rigid or requires additional clarification and enhancement.

Primary Comments
In general, we believe the Proposed Standard unduly limits the reliance that can be placed upon the work performed by internal audit by not recognizing the independence of internal audit from management. It also does not permit the external auditor to exercise sufficient professional judgment and discretion when performing an audit of internal control over financial reporting. In addition, the Proposed Standard prescribes too low of a threshold to be workable when evaluating a significant deficiency or material weakness.

(1) The Proposed Standard should permit more reliance to be placed on Internal Audit and allow the external auditor more discretion when conducting an audit of internal control over financial reporting

Internal audit is chartered with providing an objective viewpoint of an organization and will, in larger organizations, functionally report directly to the audit committee (and only administratively to management). Furthermore, the audit committee must annually approve internal audit's

[1] Paragraph 42 of the Proposed Standard states, "As part of understanding and evaluation of management's process, the auditor should obtain an understanding of the results of procedures performed by others. Others include internal audit and third parties working under the direction of management, including other auditors and accounting professional engaged to perform procedures as a basis for management's assessment."

detailed audit plans, including budgets and staffing, and assess the performance of the internal audit function. This reporting alignment allows internal audit to remain independent from the decisions made by management. In cases where the internal audit department is "competent" and "objective,"[2] and where it reports directly to the audit committee, the external auditor should be allowed to rely more extensively on internal audit's test work. This includes test work performed for routine and non-routine transactions, including the routine portion of the period-end financial reporting process and walkthrough testing of significant processes.

In a financial statement audit, the external auditor is allowed to rely on the work performed by internal audit, provided that the external auditor follows the guidance in SAS No. 65. It seems only reasonable, prudent and effective that the external auditor be allowed to follow the same guidance when performing an audit of the internal control over financial reporting. Following the same guidance, the level and amount of reliance that is placed on the internal audit function would then be left to the external auditor's professional judgment and discretion.

Based on this rationale, discretion should be given to the external auditor when conducting walkthrough tests of a company's significant processes, testing of controls in the control environment, testing of controls in the period-end financial reporting process and testing of controls that may have a pervasive effect on the financial statements. For large financial institutions that are heavily regulated, internal audit may already perform the same procedures that the Proposed Standard mandates to the external auditor. As the Proposed Standard is currently written, the external auditor would be required to duplicate this effort while ignoring the competency and objectivity of internal audit. This duplication of effort will result in an undue burden on management.

We recommend that the Proposed Standard make a clear distinction between management and internal audit. Also, it should make specific reference to SAS No. 65 and allow the external auditor to follow this guidance when performing an audit of internal control over financial reporting. Finally, the Proposed Standard should allow the external auditor discretion to determine whether its direct testing or internal audit's testing will provide the primary evidence for the audit.

(2) The threshold for a "significant deficiency" and "material weakness" is too low and is inconsistent with FDICIA and SEC guidelines

The Proposed Standard requires the external auditor to issue an adverse opinion when a material weakness has been identified. However, we believe the Proposed Standard sets the threshold for evaluating what constitutes both a significant deficiency and material weakness far too low in relation to existing auditing guidance. In addition, in designing systems of internal control over financial reporting, an organization must balance the cost of the control with the benefit of assurance over accuracy and integrity of financial reporting. To design a system of internal control which adequately captures all events which are more than inconsequential in amount and which may have more than a remote likelihood of occurring may be cost prohibitive, or in some cases, functionally impractical. Furthermore, the Proposed Standard should ensure that the

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[2]The terms "competent" and "objective" are used in the same context as the terms are used in SAS No. 65, *"The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements."* It would be expected under an audit of internal control over financial reporting that the external auditor would assess the competency and objectivity of the internal audit department as further described in SAS No. 65, paragraphs .09 - .11.

concepts of "significant deficiency" and "material weakness" are defined consistently with guidelines that are currently being utilized by banking regulators. This will help to ensure consistent application of the Proposed Standard and will help to reduce confusion in the marketplace.

The Proposed Standard introduces the concepts of "more than a remote likelihood" and "more than inconsequential in amount" when evaluating internal control deficiencies, creating a significantly broader and lower threshold for what constitutes a significant deficiency and material weakness than currently exists. By definition, misstatements assessed as having more than a remote likelihood of occurrence and being more than inconsequential in amount could be interpreted as inclusive of any deficiency identified during the audit of internal control over financial reporting. This essentially characterizes any internal control deficiency as a significant deficiency or material weakness. This could result in the external auditor improperly classifying any deficiency as significant or material when such deficiency may actually have a minimal impact on the financial statements. Furthermore, we believe that the definition of a significant deficiency and material weakness in the Proposed Standard is inconsistent with the concept of "materiality" as described in Staff Accounting Bulletin (SAB) No. 99, *"Assessing Materiality."* These terms should be consistent if an auditor is to report on both the financial statements and on internal control over financial reporting.

Assuming that it is not the Board's intention to require *all* identified deficiencies to be classified as either significant deficiencies or material weaknesses, we recommend that the Proposed Standard clarify that the threshold for both a significant deficiency and material weakness is a level where the risk of misstatement is "at least reasonably likely" and "material." This would provide consistency with the "reasonable assurance" and "reasonable likelihood" terminology utilized in Paragraph 183 of the Proposed Standard and similar terminology used in SAB No. 99.

The definitions of material weakness and reportable conditions, as defined in SAS No. 60, are widely accepted and used in current practice to make assessments on internal control over financial reporting under the FDICIA Act of 1991. The Proposed Standard creates the possibility of inconsistency in reporting on internal controls as financial institutions are subject to both FDICIA regulations and Section 404 of the Sarbanes-Oxley Act of 2002. Based on current guidance, financial institutions would be required to report reportable conditions and material weaknesses on two different levels of criteria. This could result in conflicting assessments on internal control over financial reporting by management and the external auditors during the same time period. This could cause inconsistency in the reporting on internal control over financial reporting to investors and regulators. We recommend that the Proposed Standard utilize the definitions in SAS No. 60, *"Communication of Internal Control Matters Noted in an Audit,"* SAB No. 99 and FDICIA.

Additional Comments:

(3) The Proposed Standard should not prescribe what circumstances constitute a significant deficiency or material weakness

In paragraph 126, the Proposed Standard lists specific circumstances that should represent, at a minimum, a significant deficiency and could be a strong indication of a material weakness. A material weakness or significant deficiency should be based on facts and circumstances unique to the underlying situation. It should not be prescribed in a list that precludes or inhibits the external auditor's professional judgment and discretion.

While we agree certain circumstances may be more indicative of a significant deficiency or material weakness, each underlying situation should be evaluated according to the facts and circumstances and should be based on the external auditor's judgment and discretion. The Proposed Standard should be amended to provide that the circumstances in Paragraph 126 be characterized as indicators, not requirements.

For instance, when financial statement audits are performed, differences in views between management and the external auditor concerning judgments related to the interpretation and subsequent application of complex accounting standards or judgments in estimates and assumptions may arise. When significant judgment is involved in the interpretation and application of complex accounting standards for which current guidance is vague and subject to interpretation[3] or when there is significant judgment pertaining to valuations and estimates, there may be times when the resolution of differing views could result in a proposed audit adjustment even though adequate and effective controls over financial reporting may be in place.

(4) The procedures and scope of work to be performed by external auditors when providing a consent on the report of internal control over financial reporting

In paragraphs 181 and 182, the Proposed Standard requires that the external auditor perform bring-down procedures from the date of his or her report on the internal control over financial reporting to the date of the consent. However, the Proposed Standard is silent on (1) the types of bring-down procedures the external auditor is expected to perform and (2) the level of comfort that the external auditor is expected to provide in a consent. The Proposed Standard would be better served if it provided general guidance on the types of procedures that external auditors are to perform when providing consent to reissue the report on internal control over financial reporting. In addition, the Proposed Standard should clarify that the scope of an external auditor's bring-down procedures would be to identify any adverse changes in internal control over financial reporting during the intervening period that would have had an impact on the external auditor's report.

(5) Scope extension to contingent liabilities

Paragraph 74 of the Proposed Standard requires that the external auditor obtain evidence about the effectiveness of controls for all relevant assertions related to all significant accounts and disclosures in the financial statements. Appendix B, paragraph B19 provides guidance that an auditor should follow in identifying significant accounts related to contingent liabilities.

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[3] SFAS No. 133, SFAS No. 140 or FIN No. 46 are just a few complex accounting standards where there is neither accounting consistency across companies nor consistency across external audit firms regarding all interpretations. SFAS No. 133, SFAS No. 140 and FIN No. 46 refer to the following accounting standards: Statement of Financial Accounting Standards (SFAS) No. 133, *"Accounting for Derivatives and Hedging Activities,"* as amended by SFAS No. 138 and SFAS No. 149; SFAS No. 140, *"Accounting for Transfers and Servicing of Assets and Extinguishment of Liabilities – a Replacement of FASB Statement No. 125"*; and FIN No. 46, "*Consolidation of Variable Interest Entities – An Interpretation of ARB No. 51."*

We believe the scope of the Proposed Standard is excessive in requiring the external auditor to assess the potential impact that contingent liabilities may have on the financial statements or disclosures thereto when such contingent liabilities are inconsequential (or not reasonably estimable) and the likelihood of occurrence is less than probable.[4] The example in paragraph B19 would suggest that the external auditor evaluate all contingent liabilities (legal, environmental, etc.) for which there is a remote possibility of occurrence but could have a significant potential impact on the financial statements. While it is necessary to have controls over financial reporting related to the capture of contingent liabilities, the Proposed Standard should limit the scope of the audit work that external auditors need to perform. External auditors should only be required to evaluate the internal controls related to identifying, processing and disclosing material contingent liabilities.

Bank One appreciates the opportunity to comment on the Proposed Standard. If you have any questions on this comment letter or would like any additional information, please do not hesitate to contact either Melissa J. Moore at (312) 336-4060 or Jeffrey T. Rigg at (312) 954-3311.

Very truly yours,

Melissa J. Moore

Melissa J. Moore
Controller and
Chief Accounting Officer

Jeffrey T. Rigg

Jeffrey T. Rigg
General Auditor

[4] The terms "probable" and "reasonably estimable" are used in the same context as paragraph 3 of SFAS No. 5, *"Accounting for Contingencies."*