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February 23, 2007

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

Re: **PCAOB Rulemaking Docket Matter No. 021**
Proposed Auditing Standard – *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements and Related Other Proposals*

Dear Sir or Madam:

Deloitte & Touche LLP is pleased to respond to the request for comments from the PCAOB with respect to its Proposed Auditing Standard – *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements and Related Other Proposals* [PCAOB Release No. 2006-007; PCAOB Rulemaking Docket Matter No. 021]. The comments provided herein are based on our insights and experiences in performing integrated audits. Our insights and experiences include those of the non-U.S. member firms of Deloitte Touche Tohmatsu.

Overall, we are supportive of the fundamental concepts within the proposals, and we commend the PCAOB for its efforts in their development. We believe investors have greatly benefited from reporting about the effectiveness of internal control over financial reporting (hereinafter ICFR) and that such reporting by management and the related requirement for an auditor's attestation report has improved disclosures to investors about internal control related matters, enhanced the reliability of financial statements, and has placed a stronger focus on the importance of management's responsibilities relative to the establishment and maintenance of effective ICFR. There are three overriding concepts within the proposals for which we would like to specifically express our support.

First, we strongly support the PCAOB's commitment to a single, scalable audit standard. We strongly believe that applying a single, scalable standard for performing integrated audits is in the best interest of investors. A system whereby different rules apply to issuers of different sizes would be very difficult for investors to understand, and we believe would result in much confusion and less valuable information being provided to investors. Moreover, only a truly scalable system is consistent with a principles-based and top-down, risk-based approach to assessing ICFR. A tiered system with different requirements for various categories of issuers based on bright-line rules such as company size, as has been suggested by some commentators, would constrain the use of auditor judgment in favor of artificial criteria. A single, scalable system, on the other hand, is consistent with the use of judgment by auditors in considering the risks and circumstances of each company, based on its nature and complexity.

Second, we strongly support the requirement that the auditor perform an audit of the effectiveness of ICFR, including an evaluation of design and operating effectiveness. Alternatives based on limiting

the scope of the auditor's work in some or all circumstances, such as reporting only on design-effectiveness and implementation of internal control (i.e., not testing operating effectiveness), would be confusing to understand and would substantially decrease the benefits of Section 404 to investors.

Third, we strongly support the principles-based nature of both the proposed standard on auditing ICFR and the proposed standard on considering and using the work of others in an audit. We believe that the proposed standard on auditing ICFR will allow the auditor to effectively use judgment to tailor the audit to accommodate a company's specific characteristics (e.g., size and complexity) within the framework of a top-down risk based approach. It is however important to note that the principles-based nature of the proposed standards and the increased focus on the use of judgment will result in variability in the application of the standards by auditors. We believe that such variability is appropriate and ultimately will increase the effectiveness and efficiency of the integrated audit as auditors use judgment to tailor their processes to specific companies. We encourage the Board to continue to support the use of appropriate judgment by auditors in its standard setting process and to also encourage support thereof in its inspection program.

Based on our analysis of the proposed standards we have identified two broad issues which in our view, if addressed by the Board, will greatly contribute to the accomplishment of the Board's overall objective of preserving the intended benefits of an audit of ICFR while improving the efficiency of the process. We strongly believe that addressing the issues described below will allow the auditor the flexibility to exercise professional judgment in a manner that will facilitate an audit of ICFR in the most efficient manner, but at the same time not jeopardizing audit quality.

- *Use of the Work of Others*

  We support the Board's objective of "removing the barriers to using the work of others", and we therefore support the elimination of requirements within Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements* (AS No. 2) that restrict the ability of the auditor to use management's work in an audit of ICFR in situations where it might otherwise be appropriate. We believe that the proposed standard on auditing ICFR will better provide the auditor with the appropriate flexibility to exercise judgment in using management's work in a manner that will improve the efficiency of the audit, without compromising audit effectiveness.

  Additionally, we are supportive of the principles underlying the proposed auditing standard on using the work of others in an audit; however, we do not believe that these principles and the overall intent of the proposed standard differ substantially from AU sec. 322 *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements* (AU 322).

  We recommend that instead of proposing a new standard, that the Board modify AU 322 to specifically indicate that this standard is not limited only to internal auditors, but that it is also applicable to others who have the appropriate levels of competency and objectivity. We believe that this modification of AU 322 together with the proposed modifications to AS No. 2, would provide the auditor with the appropriate framework to work with his or her client in order to use management's work in an appropriate and efficient manner. We are concerned that by replacing AU 322 with the proposed standard, the Board may inadvertently create confusion and possibly incremental effort for the auditor, without necessarily enhancing audit quality and efficiency.

- *Use of Certain Terms*

  Under the Board's Rule 3101 *Certain Terms Used in Auditing and Related Professional Practice Standards*, the auditor is required to fulfill specific responsibilities within an audit standard based on use of the word "must" or a "should" (i.e., an "unconditional" or a "presumptively mandatory" responsibility, respectively). In order for the auditor to demonstrate that he or she has fulfilled these responsibilities, and to comply with Auditing Standard No. 3, *Audit Documentation* (AS No. 3), he or she must have appropriate documentation within the working papers demonstrating what procedures were performed relative to each instance of a "must" or "should". We noted that there are in excess of 250 instances within the proposed standards where either an unconditional or presumptively mandatory responsibility is created for the auditor. These requirements will result in required procedures and a level of documentation that will have a significant impact on the time and effort involved in the audit, but may not add to the level of audit effectiveness.

  Additionally, we noted certain instances where it is not clear how the auditor would be expected to document or demonstrate compliance with the presumptively mandatory responsibilities imposed within the proposed standards. In some cases, what are drafted as presumptively mandatory requirements (i.e., "should") appear to be factual statements, guidance or factors for the auditor to consider in fulfilling responsibilities relative to a higher level requirement. Therefore, we recommend that the Board limit the use of "must" and "should" within the proposed standards to only the primary objectives, or the broad principles applicable to performing an audit of ICFR (such as "the auditor must obtain sufficient competent evidence about the design and operating effectiveness of controls over all relevant assertions"). This will allow the auditor to work with his or her client to plan and perform the most effective and efficient audit and not focus on performing procedures and preparing excessive documentation to demonstrate compliance with all of the over 250 occurrences of these words. (See our response in the section titled "Other Comments" below for further details.)

Finally, we support all efforts to continuously improve the effectiveness and efficiency of the Section 404 assessment process (including both management's assessment and the integrated audit). We believe the steps underway to provide principles-based guidance to management and to replace AS No. 2 with the proposed standard (both endorsing a scalable risk-based approach and allowing auditors to use more judgment) will achieve the goal of making the Section 404 process more cost-effective. We believe experience in the last several years indicates that costs associated with the Section 404 process have been declining. For example, various studies and surveys have shown that there have been significant reductions in overall Section 404 costs (internal costs, third party costs, as well as external audit fees) in the second year of implementation for accelerated filers.[1] We believe that the combined efforts underway by the Securities and Exchange Commission (SEC), the PCAOB (including work being done to develop guidance for conducting audits of ICFR of smaller public companies), as well as other efforts by the Committee of Sponsoring Organizations (COSO) will support additional improvements and refinements in the Section 404 process.

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[1] The Sarbanes-Oxley Section 404 Costs and Implementation Issues: Spring 2006 Survey Update by CRA International indicates that total 404 costs declined significantly in year 2 of implementation, falling 30.7 percent for Smaller Companies and 43.9 percent for Larger Companies. Additionally, results of the March 2006 FEI Survey on SOX Section 404 Implementation indicates that the total average cost for Section 404 compliance was $3.8 million during fiscal year 2005, down 16.3 percent from 2004.

Specifically, we expect the proposed changes, along with the proposals by the SEC, will result in a reduction of total Section 404 costs, due to various specific, positive changes in the proposals. These would include the ability of an auditor to (a) determine audit coverage based upon risk, without any pre-established quantitative coverage requirement, relative to an issuer's operations, (b) adjust, under certain conditions, the nature, timing and extent of testing of particular controls, based in part on cumulative experience gained in prior audits, c) adjust and scale the nature, timing and extent of audit work, based on the size and complexity of an issuer's operations, and (d) increase the use of the work of others, if certain conditions are met.

In voting to propose these standards, Board Member Kayla Gillan noted that, although she expected the proposals to result overall in more efficient audits of ICFR, "the proposal will not reduce audit costs by X percent for all companies."[2] We agree with this statement because the efficiencies achieved will vary significantly based on the facts and circumstances for each particular company, the state of the ICFR within each company, and the extent to which management already has effective ICFR in place. We also believe that opportunities for efficiencies and effectiveness in the Section 404 process can be obtained if the auditor can use management's work to the maximum extent permitted under the standards. While management's evaluation and assessment of ICFR and the audit of ICFR are separate activities and need not be conducted in the same manner, there is important interaction between the two through the auditor's consideration of the work of others and the ability of the auditor to use the company's documentation as evidential matter to support the auditor's opinion. As a result, the manner in which management conducts its assessment, the competence and objectivity of those testing ICFR to support management's assessment, and the documentation available to support that assessment directly impact the potential efficiency of the audit process.

For example, to the extent management decreases its reliance on self assessment for the purposes of supporting its assessment of ICFR and increases the extent of direct testing performed by highly competent and objective personnel or third parties, the auditor's ability to use management's work is increased, which would result in decreased audit effort and expense. Similarly management's approach to the documentation of its ICFR and its assessment of effectiveness also impact the work of the auditor in that, to the extent management's documentation is sufficient to comply with auditing standards related to audit documentation, decreased audit effort and expense will be required to prepare the documentation necessary to evidence the procedures that the auditor has performed and the basis for conclusions reached.

We would also like to note that, although we support the objective of conducting an effective audit in an efficient manner, we are concerned that the heightened focus on efficiencies within the text of the proposed standards and related communications is unusual and may detract from the overarching objective of generally accepted auditing standards, which is to set forth the performance standards for an effective audit.

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[2]See opening statement by Kayla Gillan, PCAOB Open Meeting December 19, 2006. It is also important to note that there are other significant factors that impact audit costs besides costs associated with assessing ICFR. These include additional audit procedures and documentation requirements based on other new accounting and auditing standards (including the implementation of recommendations from the inspection process), increased demand and intense competition for accounting and auditing resources, increased compliance and regulatory requirements for auditors, practice protection costs, and litigation.

As discussed above, we are supportive of the PCAOB's proposals; however, based on our analysis of the proposed standards, we do have some specific comments in response to the questions posed in the release along with some additional comments. These are provided in the attached Appendix.

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The issues presented here are complex and may warrant further discussion to fully understand the implications of particular comments made by us and by other commenters. As such, we would suggest that the PCAOB engage in active dialogue with issuers and auditors as comments on the proposals are evaluated and changes to the proposed standards are considered. Such a dialogue will facilitate complete understanding of the comments and the consideration of related implications and likely results, and we believe, will ultimately improve the final standards and the ability for them to be implemented effectively and efficiently.

We would welcome the opportunity to further discuss these issues with the Board and the staff. If you have any questions or would like to discuss these issues, please contact Robert Kueppers at (212) 492-4241, James Schnurr at (203) 761-3539 or John Fogarty at (203) 761-3227.

Very truly yours,

/s/ Deloitte & Touche LLP

cc: Mark W. Olson, Chairman
Kayla J. Gillan, Member
Daniel L. Goelzer, Member
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Chairman Christopher Cox, Securities and Exchange Commission
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Commissioner Roel Campos
Commissioner Annette Nazareth
Commissioner Kathleen Casey
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John White, Director, Division of Corporation Finance
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APPENDIX
Questions Regarding Directing the Auditor's Attention Towards the Most Important Controls

1. Does the proposed standard clearly describe how to use a top-down approach to auditing internal control?

We believe that the proposed standard adequately describes the steps involved when applying a top-down approach to auditing internal control over financial reporting. However, we believe that the proposed standard could be enhanced by more clearly describing the linkage between the auditor's understanding of management's control objectives and the selection and testing of controls relevant to achieving these objectives. As drafted, paragraph 47 of the proposed standard is the first time that control objectives are mentioned and this paragraph sets forth the requirement that the auditor evaluate the design effectiveness of controls by determining whether or not such controls satisfy the company's control objectives. In order to more effectively link this process with the auditor's requirements to identify and understand the company's significant processes and to identify relevant controls to test, we recommend that paragraph 34 be expanded to acknowledge that as part of understanding each significant process, the auditor should understand the control objectives that management has identified related to each significant account and the related relevant assertions and the related controls that are intended to satisfy these objectives.[3] We suggest that the third bullet in paragraph 34 be replaced with the following:

- Identify the relevant control objectives and the controls that management has implemented to satisfy these control objectives

Additionally, in paragraph 37, we recommend replacing the third bullet with the following:

- Evaluate the effectiveness of the design of controls by determining whether the controls, if operating effectively, would satisfy the control objectives

2. Does the proposed standard place appropriate emphasis on the importance of identifying and testing controls designed to prevent or detect fraud?

As written, we are concerned that certain aspects of the proposed standard may lead the auditor to believe that consideration of the risk of fraud and identification and testing of the related controls that address fraud risks is a separate and distinct process from the rest of the audit. Consistent with our response to the previous question, we believe management should identify control objectives related to each significant account and relevant assertion.[3] The proposed standard might emphasize that such control objectives should address the risk of material misstatement which might arise as a result of fraud or error.

We recommend that paragraph 8 more clearly articulate that the auditor's assessment of the risk that a material weakness could exist in a particular area of the company's internal control over financial reporting specifically includes consideration of the risk of potential misstatement due to fraud and error, as well as the risk of management override of controls. Once the risk that a material weakness could exist has been properly assessed, then the underlying concepts of the

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[3] The auditor would need to recognize that management may use terms other than significant account, relevant assertion, and control objective which have the same general meaning as these terms in the context of internal control.

audit procedures to understand and evaluate the relevant controls that address the assessed risks are the same regardless of whether the risk of potential misstatement is related to error or fraud. However, more rigorous procedures are clearly necessary related to controls that address the risk of potential misstatement due to fraud. The following are some examples where we believe fraud-related considerations could be better integrated, though these may not be the only instances where this concept could be incorporated:

- Paragraph 27 - This paragraph refers to the auditor's requirement to evaluate components of a potential significant account to determine if they are subject to substantially differing risks. This paragraph could be clarified to draw attention to the fact that this includes situations where components differ in terms of the risk of fraud (e.g., customer receivables versus related-party receivables within the trade receivables significant account).

- Paragraph 31 – The first sentence of this paragraph states that "to identify relevant assertions, the auditor should determine the likely sources of those potential misstatements in each significant account that would cause the financial statements to be materially misstated." This sentence could be modified to clarify that this includes potential misstatements due to error and fraud.

- Paragraph 37 – We recommend modifying the first bullet to clarify that the use of "significant risk of misstatement" includes the risk of misstatement due to error or fraud. If this amendment is made there would not be a need to include the words "including those related to the prevention or detection of fraud", in the second bullet under the premise described in the first paragraph above.

If our proposed amendment is made to paragraph 8 and appropriate clarifications are made throughout the standard that the risk of potential misstatement relates to the risk associated with fraud and error, then we do not believe that the separate section "Fraud Controls" (paragraph 45 and 46) is necessary. The concept in paragraph 45 is the one we believe should be incorporated into paragraph 8. Paragraph 46 as drafted seems to restrict the requirement to consider the impact of control deficiencies on the nature, timing and extent of procedures to be performed during the financial statement audit to deficiencies in controls designed to address the risk of material misstatement due to fraud. We believe that this requirement should apply to all controls, and therefore we suggest that the last sentence of paragraph 46 be moved into a separate section so that it does not appear only to be applicable to "fraud controls", and revised as follows:

> "If the auditor identifies deficiencies in controls ~~designed to prevent and detect fraud~~ during the audit of internal control over financial reporting, the auditor should alter the nature, timing, or extent of procedures to be performed during the financial statement audit to be responsive to such deficiencies~~, as provided in AU sec. 316 .44 and .45~~."

We also strongly recommend that the proposed standard include guidance related to the auditor's consideration of company-level controls when identifying controls to address the risk of material misstatement due to fraud; in particular whether a company-level control can, by itself, address such a risk, and if so, what the characteristics of such a control would need to be (including the degree of precision with which the control needs to be designed to operate). We believe guidance of this nature is necessary, given the emphasis on and importance of company-level controls when applying a top-down approach to auditing internal control.

3. Will the top-down approach better focus the auditor's attention on the most important controls?

We believe that applying a top-down, risk based approach enables the auditor to identify and test those controls that have the most pervasive effect in terms of addressing the risk of material misstatement to the financial statements (i.e., effective application of a top-down approach enables the auditor to minimize the number of controls that are tested by identifying those controls that address the greatest number of control objectives related to significant accounts and relevant assertions). It is important to highlight that, as stated in paragraph 3 of the proposed standard, in order for the auditor to obtain reasonable assurance about whether a material weakness exists as of a specified date, "the auditor must obtain sufficient competent evidence about the design and operating effectiveness of controls over all relevant assertions". Consequently in evaluating whether it is necessary to identify a lower level control, or whether a high level control (if properly designed and operating effectively) sufficiently addresses the risk of material misstatement, a significant consideration is the level of precision at which the control needs to be designed to operate. A control that is not sufficiently precise will not provide sufficient competent evidence (see response to question 4 for additional comments).

4. Does the proposed standard adequately articulate the appropriate consideration of company-level controls and their effect on the auditor's work, including adequate description of when the testing of other controls can be reduced or eliminated?

We believe that the proposed standard appropriately describes the auditor's consideration of company-level controls when performing an audit of internal control and also properly acknowledges the limitations of company-level controls. The discussion of these controls in the SEC's proposal "*Management's Report on Internal Control Over Financial Reporting*" contains similar guidance about the need for management to consider the nature of company-level controls and how they relate to the financial reporting element. The SEC's proposal also includes a useful discussion explaining that the more indirect the relationship to a financial reporting element, the less effective the control may be in preventing or detecting a misstatement, and provides illustrative examples of directly and indirectly related company level controls (see pages 26 and 27 of the SEC's proposal). We believe that the proposed auditing standard would be strengthened by inclusion of similar guidance. This would also contribute to the consistency of management and the auditor's approach to the consideration of company-level controls.

We strongly support the inclusion of Paragraph 43 in the proposed auditing standard, which appropriately indicates that "some company-level controls are designed to operate at the process, transaction, or application level and might adequately prevent or detect on a timely basis misstatements to one or more relevant assertions". Given that this is such an important and fundamental concept and also that many of the types of company-level controls listed in paragraph 18 would not fall into this category, we believe that it would be useful to provide an example of the type of company-level control that might adequately prevent or detect on a timely basis misstatements to one or more relevant assertions. We also believe that acknowledgement of this concept in paragraph 17 where company-level controls are first discussed would be appropriate.

We also strongly support the parameter in paragraph 43 that company-level controls are not always designed to operate at a level of precision that would sufficiently address the risk of misstatement associated with significant accounts and assertions. We believe however that the proposed standard should more specifically recognize that in order to appropriately address the

risk of misstatement for a given assertion, company-level controls must operate at a level of precision that would detect misstatements that are less than material to the financial statements, in order to appropriately consider aggregation risk. By way of illustration, if there are many company-level detective controls in a company with a large number of business units and such controls are designed to detect only material misstatements, the risk of misstatement for any given assertion addressed by those controls would not be properly addressed because of the strong likelihood that the misstatements not detected by these controls could aggregate to an amount in excess of materiality.

Additionally, as discussed in question 2 above, in order to illustrate how consideration of fraud is integral to the audit process, we recommend that the standard incorporate guidance regarding the role of company-level controls in the auditors' identification and testing of controls that address the risk of misstatement due to fraud. In particular we believe the standard should address whether company-level controls alone would be sufficient to address the risk of misstatement for a given assertion subject to a specific fraud risk.

Emphasizing the Importance of Risk Assessment

5. Does the proposed standard appropriately incorporate risk assessment, including in the description of the relationship between the level of risk and the necessary evidence?

We believe that the proposed standard appropriately incorporates risk assessment. However, as discussed in our response to question 2 above, we recommend expanding paragraph 8 to incorporate the fact that risk assessment includes the assessment of the risk of material misstatement due to fraud as well as error.

We also believe that additional guidance is necessary to assist the auditor to understand how to evaluate company-level controls and controls designed to address the risk of misstatement due to fraud and management override in the context of paragraph 51 when determining how much evidence is necessary and the nature, timing, and extent of the procedures to obtain such evidence. For example, we believe that there may be instances where company-level controls alone will not address a fraud risk.

6. Would the performance of a walkthrough be sufficient to test the design and operating effectiveness of some lower risk controls?

We believe that the performance of a walkthrough would provide the auditor with sufficient evidence with respect to the design and operating effectiveness of controls that address low risk assertions in certain circumstances. See our response to question 17 for additional comments as to when this might be appropriate.

Revising the Definitions of Significant Deficiency and Material Weakness

7. Is the proposed definition of "significant" sufficiently descriptive to be applied in practice? Does it appropriately describe the kinds of potential misstatements that should lead the auditor to conclude that a control deficiency is a significant deficiency?

We believe the definition of "significant" is descriptive enough to be applied in practice. However, we recommend that the note to the definition be expanded to more specifically

emphasize that the determination of whether or not a misstatement is significant includes consideration of both quantitative and qualitative factors.

Additionally, although we are supportive of the principles-based nature of this definition, we would like to highlight that the assessment of whether or not a control deficiency is a significant deficiency will rely substantially on the judgment of the individual auditor and his or her assessment of what is "important enough to merit attention by those responsible for oversight of the company's financial reporting". Consequently there will likely be diversity in practice (albeit within acceptable limits) as deficiencies that appear to be similar might be classified differently from one engagement to another.

8. Are auditors appropriately identifying material weaknesses in the absence of an actual material misstatement, whether identified by management or the auditor? How could the proposed standard on auditing internal control further encourage auditors to appropriately identify material weaknesses when an actual material misstatement has not occurred?

Identifying a material weakness in the absence of an actual material misstatement requires substantial judgment, including consideration of the likelihood of a misstatement occurring, the magnitude of the potential misstatement, and the effectiveness of any compensating controls that might exist. These considerations involve projecting and predicting actual outcomes that are similar to the judgments that management and auditors must make involving significant management estimates in financial statements. Similarly, when actual results vary significantly or materially from those estimated or expected, it does not necessarily mean that there was an error in the original judgment based on the information known at the time the original judgment was made. We believe that over time, as management and auditors gain more experience, practice will improve in this area.

It is also important to highlight that in performing procedures to support the assessment, management may identify and take action to remediate many deficiencies (including those deficiencies brought to their attention by auditors). If unremediated, some of these deficiencies might otherwise have resulted in material misstatements, or have otherwise escalated into material weaknesses at the annual reporting date.

9. Will the proposed changes to the definitions reduce the amount of effort devoted to identifying and analyzing deficiencies that do not present a reasonable possibility of material misstatement to the financial statements?

We do not believe that the changes in the definitions will substantively impact the effort involved in the identification and evaluation of deficiencies, as we have always understood the concepts of "more than remote" and "reasonably possible" to be the same. We also believe the standard is clear that the auditor is not required to identify deficiencies that do not present a reasonable possibility of a material misstatement to the financial statements. We do however support paragraph 70 of the proposed standard which requires the auditor to evaluate the severity of each control deficiency to determine whether they individually or in combination are significant deficiencies or material weaknesses as of the date of management's assessment.

Revising the Strong Indicators of a Material Weakness

10. **Should the standard allow an auditor to conclude that no deficiency exists when one of the strong indicators is present? Will this change improve practice by allowing the use of greater judgment? Will this change lead to inconsistency in the evaluation of deficiencies?**

    We believe the standard should allow an auditor to conclude that no deficiency exists when certain of the strong indicators are present. We believe that this change will improve practice by enabling the auditor to exercise greater professional judgment in this area, particularly in the case of a restatement of previously issued financial statements for the correction of an error and the identification by the auditor of a material misstatement not detected by the company's internal control over financial reporting. In these cases, we believe it is possible that a conclusion can be reached that no deficiency exists. Although we support this change it is important to note that we believe strongly that there are limited circumstances in which it would be appropriate for an auditor to conclude that a material weakness does not exist in the presence of one or more of the strong indicators.

    Any change that encourages increased use of judgment carries with it the consequence of increased diversity in the manner in which it will be applied in practice. In order to further enhance the proposed standard and improve consistency of its application, we recommend that consideration be given to bifurcating the strong indictors between those for which it is possible that no deficiency exists and those for which it is less likely that no deficiency exists (i.e., all strong indicators except for the restatement and material audit adjustment). We also recommend that additional guidance, including illustrative examples, be provided as to when the auditor might appropriately conclude that no deficiency exists in the presence of the restatement or material audit adjustment strong indicators. In practice this is a complex area that causes frustration and difficulty for management and auditors alike.

    Additionally, we have observed that the circumstances in paragraph 79 that the auditor should consider as a strong indicator of a material weakness differ from the circumstances that management would be required to consider as a strong indicator of a material weakness in the SEC's proposal "*Management's Report on Internal Control Over Financial Reporting*". Specifically, the SEC's proposed management guidance does not include as a strong indicator of a material weakness the circumstance of an ineffective risk assessment process or internal audit function at companies for which such a function needs to be effective for the company to have effective internal control over financial reporting, such as for very large or highly complex companies. With respect to an effective internal audit function, because not all companies have internal audit functions, we can understand not including an effective internal audit function among the list of strong indicators of a material weakness. However, because of the critical role of the risk assessment process within the SEC's proposed management guidance (in identifying financial reporting risks and controls) and because the risk assessment process is a primary component of internal control, we believe the lack of a risk assessment process or an ineffective risk assessment process should be considered a material weakness. As indicated in our comment letter to the SEC on its proposed management guidance, in order to make it clear that this is the case, we suggested the SEC guidance regarding strong indicators of material weaknesses be revised to include an ineffective risk assessment process or alternatively that it be explicitly stated that the lack of a risk assessment process or an ineffective risk assessment process is a material weakness.

We also wish to emphasize that different guidance for management and auditors with respect to evaluating deficiencies will result in confusion for management and auditors and will likely create inefficiencies in both management's process and the auditor's process for concluding on the effectiveness of internal control over financial reporting.

Clarifying the Role of Interim Materiality in the Audit

11. Are further clarifications to the scope of the audit of internal control needed to avoid unnecessary testing?

We believe paragraph 14 of the proposed standard appropriately sets forth that the auditor should use the same materiality considerations that he or she would use in planning the audit of the company's annual financial statements when planning the audit of internal control over financial reporting, and that no additional clarification is necessary.

12. Should the reference to interim financial statements be removed from the definitions of significant deficiency and material weakness? If so, what would be the effect on the scope of the audit?

We believe that the reference to interim financial statements should be removed from the definitions of significant deficiency and material weakness. We believe that this change is consistent with scoping the audit of internal control over financial reporting using annual materiality and reporting on the effectiveness of internal control as of the end of each annual period. Scoping the audit using annual materiality would not result in the audit being designed to detect all material weaknesses as presently defined by the proposed standard, (i.e., the audit would not be designed to detect those material weaknesses that result in a reasonable possibility that interim financial statements, but not annual financial statements, could be materially misstated). Whether or not the reference to interim financial statements is removed from the definition to resolve this inconsistency, we recommend the proposed standard be modified to specifically indicate that the auditor's objective in an audit of internal control is to express an opinion on the company's internal control over financial reporting as it pertains to annual reporting, and the auditor has no responsibility to detect control deficiencies that might result in a material misstatement of interim financial statements. Similarly, it would need to be stated that the audit of internal control over financial reporting does not encompass the controls over the preparation of interim financial statements.

Nevertheless, we recognize that accurate interim financial reporting is important to the decision making process of investors and other users of financial information. We believe that as part of the evaluation of control deficiencies that exist at the balance sheet date, the auditor should consider whether any of the identified deficiencies as of the reporting date would have a material impact on interim reporting even if these deficiencies would not materially impact annual reporting, (i.e., would not be classified as material weaknesses and would not result in an adverse opinion on effectiveness of internal control). The auditor has responsibilities to communicate control-related matters of which he or she becomes aware to management and those charged with governance, so these deficiencies would be communicated to management and the audit committee. Additionally, as part of performing an interim review of financial information, the auditor is required to obtain sufficient knowledge of the entity's internal control as it relates to the preparation of both annual and interim financial information to identify the types of potential

misstatements that might occur and to use such knowledge as a basis for the auditor's review procedures.

We would therefore be supportive of a requirement in the proposed standard for the auditor to communicate, in writing to management and the audit committee, control deficiencies that come to his or her attention that result in a reasonable possibility that a material misstatement to interim financial statements, but not the annual financial statements, could occur and not be prevented or detected. As indicated above, it should however be clearly stated in the proposed standard that the auditor has no responsibility to plan procedures to detect control deficiencies of lesser significance than those that result in a reasonable possibility that the annual financial statements could be materially misstated. Additionally, consistent with Question 32 of the Staff Questions and Answers on AS No. 2, it should be emphasized that the auditor also does not have any responsibility to evaluate and classify control deficiencies at dates other than the annual reporting date.

The impact of deficiencies that materially impact interim reporting, but not annual reporting are a consideration for management in evaluating on a quarterly basis, the effectiveness of disclosure controls and procedures, and the required quarterly disclosures about material changes in internal control in financial reporting, (i.e., including control deficiencies that materially affect or are reasonably likely to affect the entity's internal control over financial reporting, as well as the subsequent remediation of these deficiencies). Through these disclosures investors would be made aware of the existence of deficiencies that materially affect interim reporting and also when management has taken action to remediate them.

The inclusion of the reference to interim financial statements in the definitions of significant deficiency and material weakness currently drives an additional level of effort for issuers and auditors alike in the evaluation of deficiencies. The determination of materiality for quarterly reporting periods continues to present a major challenge for company management and auditors alike. In practice, materiality for quarterly reporting periods, including quarterly periods within previously issued annual financial statements, is often the subject of significant debate among management, auditors and audit committees and there are widely differing views. The lack of guidance on this subject has posed a particular challenge in the implementation of AS No. 2, because the assessment of whether or not a significant deficiency represents a material weakness depends on the potential impact of the deficiency on both interim and annual periods. We believe that this confusion and frustration would continue under the proposed standard absent further guidance from the SEC staff or others on what is considered material to interim financial statements.

Removing the Requirement to Evaluate Management's Process

13. Will removing the requirement for an evaluation of management's process eliminate unnecessary audit work?

We support the removal of the requirement for the auditor to evaluate management's annual process to evaluate the effectiveness of internal control over financial reporting; however we do not believe this change will significantly reduce the auditor's work in an audit of internal control over financial reporting. We do not believe that there is a significant level of effort involved in evaluating management's process under the current requirements of AS No. 2. We believe that this evaluation is accomplished primarily through an understanding of management's process

which is still required under the proposed standard (and of which we are supportive) and through our use of management's work.

14. Can the auditor perform an effective audit of internal control without performing an evaluation of the quality of management's process?

The auditor can perform an effective audit of internal control without performing an evaluation of the quality of management's process, however the auditor still needs to understand management's process in order to plan and perform the audit of internal control. The manner in which management completes its assessment directly impacts the work the auditor must do to complete an audit that complies with all applicable professional standards. For example:

- If management alters the manner in which it completes its assessment such that it is less objective (e.g., if management uses a self-assessment process rather than internal audit or a third party to perform testing to support its assessment), that will result in a decreased ability of the auditor to use management's work and would cause a corresponding increase in the work the auditor must perform.

- If management has limited documentation describing the company's significant processes, and/or limited documentation supporting the testing performed the auditor will be required to prepare more documentation to comply with the requirements of AS No. 3.

15. Will an opinion only on the effectiveness of internal control, and not on management's assessment, more clearly communicate the scope and results of the auditor's work?

Requiring the auditor to express an opinion only on the effectiveness of internal control will more clearly communicate the scope and results of the auditor's work. We believe that the requirement for the independent auditor to express separate opinions on (1) whether management's assessment of internal control over financial reporting is fairly stated and (2) whether the company maintained effective internal control over financial reporting is confusing to investors, auditors, and management. Many have misunderstood the language in the first part of the opinion to mean that the auditor is providing an opinion on the adequacy of management's assessment process, which is not the case.

<u>Permitting Consideration of Knowledge Obtained During Previous Audits</u>

16. Does the proposed standard appropriately incorporate the value of cumulative knowledge?

We believe that the proposed standard appropriately incorporates the value of cumulative knowledge obtained by the auditor from past audits. We strongly agree with the parameters relating to the use of knowledge obtained from past audits as outlined in the proposed standard in paragraphs 65 to 69. Notwithstanding the fact that the phrase "each year's audit must stand on its own" has been eliminated from the proposed standard, the auditor is still required in each year's audit to obtain sufficient competent evidence about the design and operating effectiveness of controls over all relevant assertions (paragraph 3). While cumulative knowledge contributes to this evidence, it does not comprise sufficient and competent evidence on its own.

17. What are the circumstances in which it would be appropriate for the auditor to rely upon the walkthrough procedures as sufficient evidence of operating effectiveness?

As discussed in our response to question 6 above, we believe that walkthrough procedures would provide sufficient evidence of operating effectiveness of controls that address low risk assertions in certain circumstances. We believe that in circumstances in which the risk of misstatement associated with a particular control is low, past audits have indicated that the control is designed and operating effectively, and the auditor has evidence that there have been no changes in the design of the control or the significant process within which it operates, it may be appropriate for the auditor to rely upon the walkthrough procedures as sufficient evidence of operating effectiveness. The auditor would also need to consider the other guidance provided in paragraphs 51 through 69 of the proposed standard when making this determination.

Refocusing the Multi-location Testing Requirements on Risk Rather than Coverage

18. Will the proposed standard's approach for determining the scope of testing in a multi-location engagement result in more efficient multi-location audits?

We support the change from a "coverage based" approach to a "risk based" approach when scoping the audit of internal control in a multi-location environment by eliminating the requirement to identify and test controls over a "large portion" of the company's operations or financial position. We believe that this approach will result in more efficient audits without jeopardizing audit quality in some circumstances, for example, where there are a large number of small decentralized locations with diverse systems and controls, and the company has effective and sufficiently precise company-level controls to detect material misstatements, after appropriate consideration of aggregation risk.

Removing Barriers to Using the Work of Others

19. Is the proposed standard's single framework for using the work of others appropriate for both an integrated audit and an audit of only financial statements? If different frameworks are necessary, how should the Board minimize the barriers to integration that might result?

Please refer to our comments regarding use of the work of others in our cover letter where we set forth that we are supportive of the concepts underlying the proposed standard, but we suggest that the proposed standard on using the work of others in an audit is not necessary. We believe the objectives of the PCAOB could be achieved by making minor modifications to AU 322. Although that is our recommendation, we have included responses to the questions below in the event the PCAOB decides to move forward with the proposed standard.

20. Does the proposed definition of relevant activities adequately capture the correct scope of activities, including activities that are part of the monitoring component of internal control frameworks?

We believe that the proposed definition of relevant activities in paragraph 4 is appropriate. To the extent that activities that are part of the monitoring component of an internal control framework would qualify as relevant activities and meet the criteria of "tests performed by others", they could be considered as relevant activities, however not all activities that are part of the monitoring component will qualify.

We are concerned however, that as currently drafted, the proposed standard creates uncertainty as to the auditor's responsibility with respect to identifying relevant activities. We believe that paragraphs 3 and 5, as proposed are likely to establish a level of work that is unintended. For example, it is not clear whether inquiry of knowledgeable management is sufficient for the auditor to identify relevant activities or whether the auditor's responsibility extends beyond inquiries. If the auditor's responsibilities extend beyond inquiries we are unsure of the additional procedures to be performed to identify relevant activities and comply with the presumptively mandatory requirements in paragraphs 3 and 5. Also, as currently drafted, we do not believe that the proposed standard sets forth that the assessment of competence and objectivity should be applied as a "filter" to what the auditor might identify as relevant activities. We believe that in order to appropriately focus the scope of the auditor's work in identifying and understanding relevant activities, it would be appropriate for the auditor to first consider the objectivity and competency of personnel who might be performing those activities. In other words, the scope of the auditor's work in this respect would then be limited to identifying relevant activities being performed by persons who are sufficiently competent and objective such that the auditor might be able to use their work, as opposed to having to understand all activities that might be relevant activities, including those being performed by persons who are not sufficiently objective and/or competent.

We strongly believe that inefficiencies will result with no impact on audit effectiveness, if the intent of the proposed standard is for the auditor to go beyond broad inquiries in identifying relevant activities and identify all relevant activities, as opposed to identifying only those relevant activities that are performed by personnel considered to be sufficiently competent and objective such that the auditor would be able to use their work.

21. Will requiring the auditor to understand whether relevant activities performed by others identified control deficiencies, fraud, or financial statement misstatements improve audit quality?

As noted in our response to question 20 above, we believe the auditor's responsibility to identify relevant activities is limited to inquiries of knowledgeable management. As the auditor already obtains written representations from management that it has made the auditor aware of all control deficiencies, fraud, or financial statement misstatements, we do not believe this requirement will have any incremental impact on audit quality.

22. Is the principal evidence provision that was in AS No. 2 necessary to adequately address the auditor's responsibilities to obtain sufficient evidence?

We do not believe that the term "principal evidence" as used in AS No. 2 is necessary to adequately address the auditor's responsibilities to obtain sufficient evidence in support of his or her opinion. In fact, the elimination of the term "principal evidence" will likely dispel many misconceptions that the determination of principal evidence was a mechanical or quantitative exercise. Notwithstanding that this term is not included in the proposed standard, we do not believe that the proposed standard changes the auditor's responsibilities, because the auditor must still obtain sufficient competent evidence to support his or her opinion, including obtaining evidence about the design and operating effectiveness of controls over all relevant assertions. We also believe that retaining AU 322, particularly paragraphs 18-22, will provide clarity with respect to the auditor's responsibility to obtain sufficient competent evidence to support the auditor's report. Please refer to our comments regarding the use of the work of others in our cover letter.

23. Does the proposed standard provide an appropriate framework for evaluating the competence and objectivity of the persons performing the testing? Will this framework be sufficient to protect against inappropriate use of the work of others? Will it be too restrictive?

Please refer to our comments regarding use of the work of others in our cover letter. We believe that the criteria in AU 322 for evaluating the competence and objectivity are appropriate.

24. Has the Board identified the right factors for assessing competence and objectivity? Are there other factors the auditor should consider?

Please refer to our comments regarding use of the work of others in our cover letter. We believe that the criteria in AU 322 for evaluating the competence and objectivity are appropriate.

25. What will be the practical effect of including, as a factor of objectivity, a company's policies addressing compensation arrangements for individuals performing the testing?

We agree that a company’s policies addressing compensation arrangements for individuals performing the testing could impact an individual’s objectivity. However, the proposed standard is not clear as to the nature of the compensation arrangements that the auditor should consider, (i.e., whether it applies to all compensation arrangements, or only those that are more likely to impact objectivity). For example, in a situation in which the individual performing the testing holds company stock in a company-sponsored 401(k) plan, specific consideration by the auditor of this compensation arrangement on the individual’s objectivity may not be necessary. However in a situation in which the individual performing the testing has an incentive arrangement that is tied directly to the maintenance of effective internal control (e.g., the individual will receive a significant bonus based on the company receiving an unqualified auditor’s report on the effectiveness of internal control), then we believe that this is a compensation arrangement that is far more likely to affect objectivity and therefore needs to be specifically considered by the auditor. We therefore believe that some additional guidance should be provided in the proposed standard as to the nature of the compensation arrangements about which the auditor should be concerned, otherwise we believe that as drafted, the proposed standard could be interpreted to require more audit effort than is intended or may be necessary.

Recalibrating the Walkthrough Requirements

26. Will requiring a walkthrough only for all significant processes reduce the number and detail of the walkthroughs performed without impairing audit quality?

We believe that it is possible that recalibrating the walkthrough requirements, as proposed, may in some circumstances result in a reduction in the number and detail of the walkthroughs performed. In general, however, we believe that major classes of transactions within significant processes are subject to different risks and involve different individuals and systems. Consequently, it is not appropriate to combine the walkthroughs of those classes of transactions. In the discussion relating to this topic in the PCAOB Release No. 2006-007 that accompanied the proposed standard, an example is provided that refers to retail sales as a significant process and distinguishes between two different major classes of transactions: store sales and internet sales. The example suggests that separate walkthroughs of the store sales and internet sales transactions

would not be necessary. We disagree with this example because we believe that in practice these two transaction types would likely be identified as two separate and distinct processes because they likely would involve different personnel, systems, revenue recognition policies, and would be subject to different risks. We do however believe that once the two transaction types reach a common point within the overall process (e.g., customer billing/collection) then it would be appropriate for the auditor to continue the walkthrough of only one transaction at that point. We believe that including an example to this effect in the proposed standard would be useful in clarifying what we believe is intended.

We also believe the walkthrough requirements in the proposed standard can be further clarified. Paragraph 34 requires the auditor to identify controls within each significant process that management has implemented to address potential misstatements. It is likely that while understanding each significant process, the auditor will identify more controls than those that the auditor ultimately decides are necessary in order to address the relevant assertions (i.e., those controls that are identified from a top-down approach and therefore, will be subject to evaluation of the design and testing of the operating effectiveness). Paragraphs 36-37 however require the auditor to perform the walkthrough of the significant process and verify whether the "controls" have been designed appropriately and placed into operation. It is not clear whether this requirement pertains to all the controls identified in paragraph 34 or only those controls that the auditor has concluded are necessary in order to address the relevant assertions related to the significant accounts (i.e., those that will also be selected for operating effectiveness testing). We believe that it is the latter, but clarification of this in the proposed standard would address the risk that the requirements of paragraph 37 might be misinterpreted and cause unnecessary audit effort.

In addition, we recommend that within paragraph 37 the use of the word "verify" be replaced with the word "determine". The use of the word "verify" in this context could also drive more audit effort than what we believe is intended and which would be necessary.

Finally, page 27 of the PCAOB's release contains the statement that the "…proposed standard's emphasis on the role of probing inquiries is meant to clarify that the auditor is not required to follow a separate transaction through each minor variance in the process." In certain circumstances we believe this might result in a reduction in the detail of walkthroughs. The proposed standard does not however contain a clear description or discussion of this concept and we are therefore concerned that it will likely be overlooked or misapplied, and any potential efficiencies that may result would not then be achieved.

27. Is it appropriate for the auditor to use others as direct assistance in performing walkthroughs? Should the proposed standard allow the auditor to more broadly use the work of others in performing walkthroughs?

We believe that it is appropriate for the auditor to be able to use others as direct assistance in performing walkthroughs. However, we do not believe that this would be appropriate in areas involving a high degree of judgment or subjectivity and/or if there is a high risk of material misstatement (e.g., a process to develop significant accounting estimates). We believe that the requirement to perform walkthroughs is one of the most significant aspects of an audit of internal control (i.e., walkthroughs directly support the auditor's evaluation of the design of internal control and also the assessment of the risk of misstatement, including the risk of fraud).

Scaling the Audit for Smaller Companies

28. Does the proposed standard on auditing internal control appropriately describe how auditors should scale the audit for the size and complexity of the company?

We are supportive of the guidance provided in the proposed standard regarding scaling the audit for size and complexity considerations. We also support the efforts of the PCAOB to develop guidance for conducting audits of internal control over financial reporting of smaller public companies. We believe that additional guidance as to how auditors might scale the audit for the size and complexity of a company would be beneficial.

29. Are there other attributes of smaller, less-complex companies that the auditor should consider when planning or performing the audit?

No, we believe the attributes identified in the proposed standard are appropriate.

30. Are there other differences related to internal control at smaller, less complex companies that the Board should include in the discussion of scaling the audit?

No, we believe the proposed standard has identified the primary differences that the auditor should consider in this regard.

31. Does the discussion of complexity within the section on scalability inappropriately limit the application of the scalability provisions in the proposed standard?

We do not believe that the proposed standard inappropriately limits the application of the scalability provisions. However, we believe that in planning and performing an audit of internal control, the focus should always be on the specific characteristics associated with a company recognizing that not all small companies have simple operations, but may also have complex aspects. For example a start-up company may be simple in many respects; but it may have certain characteristics (e.g., complex financing, unique stock-based compensation arrangements) that are complex. The controls necessary to address the more simple aspects of the start-up might be different from those applicable to a large complex organization; however, the controls over the complex aspects of the business would be more similar to, or possibly more complex than those of the large organization.

32. Are the market capitalization and revenue thresholds described in the proposed standard meaningful measures of the size of a company for purposes of planning and performing an audit of internal control?

We believe that there is no one measure that alone is determinative of the size of a company. Additionally, as discussed in our response to question 31 above, based on our experience we believe that the complexity of a company's operations and the transactions entered into by a company are the primary factors when assessing the level of sophistication of internal control necessary to address the risk of misstatement associated with financial statement assertions.

Proposed Rule 3525 – Audit Committee Pre-approval of Services Related to Internal Control

33. Is there other information the auditor should provide the audit committee that would be useful in its pre-approval process for internal control-related services?

We believe that the information that would be required to be provided to the audit committee under the proposed rule is sufficient.

Effective Date

34. How can the Board structure the effective date so as to best minimize disruption to on-going audits, but make the greater flexibility in the proposed standards available as early as possible? What factors should the Board consider in making this decision?

While we acknowledge that many of the concepts within the proposed standards can be implemented currently, we believe that in order to obtain the maximum benefit of the proposed standards with respect to audits of financial statements for years ending on or after December 15, 2007, a final standard would need to be approved no later than June 1, 2007. This would allow auditors to work in collaborative manner with management during the planning stages of the audit in order to effectively implement the proposed changes including those not permissible under the current standard. The shorter the period of time engagement teams have to implement the final standard, the more inefficient and disruptive implementation is likely to be for audits in process.

Other Comments

Rollforward Procedures

We believe that additional guidance is needed with respect to "roll-forward procedures" the auditor is required to perform when controls are tested at an interim date. Paragraphs 63 and 64 of the proposed standard imply that the auditor may not have to perform any procedures to update his or her conclusions from an interim date. This does not seem appropriate and is not consistent with paragraph 99 of AU sec. 319 "*Consideration of Internal Control in a Financial Statement Audit*" which states:

> "When the auditor obtains evidential matter about the design or operation of controls during an interim period, he or she should determine what additional evidential matter should be obtained for the remaining period. In making that determination, the auditor should consider the significance of the assertion involved, the specific controls that were evaluated during the interim period, the degree to which the effective design and operation of those controls were evaluated, the results of the tests of controls used to make that evaluation, the length of the remaining period, and the evidential matter about design or operation that may result from the substantive tests performed in the remaining period. The auditor should obtain evidential matter about the nature and extent of any significant changes in internal control, including its policies, procedures, and personnel that occur subsequent to the interim period."

We would suggest modifying paragraphs 63 and 64 of the proposed standard to make the requirements of the auditor consistent with paragraph 99 of AU sec. 319.

Use of Certain Terms

As mentioned previously we noted certain instances where it is not clear how the auditor would be expected to document or demonstrate compliance with the presumptively mandatory responsibilities placed on him or her. In some cases, statements drafted as presumptively mandatory requirements (i.e., "should" statements) instead appear to be guidance or factors for the auditor to consider or address in fulfilling responsibilities relative to a higher level requirement. Examples include but are not limited to the following:

- Paragraph 11: "Because of these attributes, the auditor should recognize that a smaller and less complex company often achieves many of its control objectives through the daily interaction of senior management with company personnel rather than through formal policies and procedures."

- Paragraph 35 – "The auditor should apply this direction when auditing internal control over financial reporting."

- Paragraph 59 – "However, the auditor should balance performing the tests of controls closer to the as-of date with the need to test controls over a sufficient period of time to obtain sufficient evidence of operating effectiveness."

Please also refer to our comments in our cover letter regarding the use of certain terms.

Auditor's Responsibilities When Pervasive Weaknesses Are Identified

We believe in circumstances when there are pervasive weaknesses in fundamental areas of internal control (e.g., control environment, risk assessment, financial closing process), the auditor could conclude without performing additional audit work that the lower level transactional controls cannot be effective. Accordingly, we believe that in these situations the standard should allow the auditor to stop further audit work and conclude that the company does not have effective internal control over financial reporting. The auditor's report in this situation would contain an adverse opinion of the effectiveness of internal control, but would indicate that additional material weaknesses might have been identified had additional procedures been completed. An example of this situation might be when the auditor has determined that a company (1) has a poor risk assessment (including fraud risk assessment) or monitoring process, and (2) does not have a sufficient number of personnel with the requisite financial reporting competencies (either internal or external) to address the types of transactions and activities into which the company enters. Additionally, we do not believe that in these circumstances requiring the auditor to complete the audit would contribute further to the quality of the financial statement audit. We also believe that in these circumstances spending the time necessary to complete the audit would provide no additional benefit to management or investors.

Additionally, we believe that if the Board modifies the proposed standard to allow work on the audit to stop in these situations, it may reduce cost burdens associated with Section 404 when the conclusion regarding the effectiveness of internal control is readily apparent based on the severity of material weaknesses identified at the outset or early in the process. This would allow management to focus resources on taking corrective actions necessary to establish effective internal control over financial reporting rather than diverting limited resources towards completing an assessment for which the ultimate conclusion is already known.

Paragraph 53- Control Deviations

We are concerned that the note to paragraph 53 might be taken out of context. Paragraph 53 requires the auditor to determine the effect of identified deviations from the company's established controls on his or her assessment of risk associated with the control and conclusions on the operating effectiveness. The note to paragraph 53 implies in this context that the auditor would not necessarily have to consider the impact of all deviations identified in his or her testing, which is not the case. We recommend that the note to paragraph 53 either be deleted or modified to clarify that this does not apply to deviations detected by the auditor in a sample designed to test the operating effectiveness of a control.