



Business Roundtable™

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February 28, 2007

VIA FACSIMILIE

Public Company Accounting Oversight Board
Attention: Office of the Secretary
1666 K Street, NW
Washington, DC 20006-2803

Harold McGraw III
The McGraw-Hill Companies
Chairman

Kenneth I. Chenault
American Express Company
Co-Chairman

Edward B. Rust, Jr.
State Farm
Insurance Companies
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John J. Castellani
President

Larry D. Burton
Executive Director

Johanna I. Schneider
Executive Director
External Relations

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

Dear Public Company Accounting Oversight Board:

This letter is submitted on behalf of Business Roundtable, an association of chief executive officers of leading U.S. companies with over \$4.5 trillion in annual revenues and more than 10 million employees. Member companies comprise nearly a third of the total value of the U.S. stock market and represent nearly a third of all corporate income taxes paid to the federal government. Roundtable companies give more than \$7 billion a year in combined charitable contributions, representing nearly 60 percent of total corporate giving. They are technology innovation leaders, with \$86 billion in annual research and development spending – nearly half of the total private R&D spending in the U.S.

Business Roundtable strongly supported the enactment of the Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley”), as well as the efforts of the Public Company Accounting Oversight Board (the “Board”) to implement Section 404 of Sarbanes-Oxley. We support the Board’s proposed new internal control standard (the “Proposal”) to supersede Auditing Standard No. 2 (“AS2”). In particular, we support those elements of the Proposal that are designed to focus on matters most significant to internal controls and that enhance the use of a top-down approach. We believe these aspects of the Proposal should make the internal controls audit process more efficient and effective for auditors and public companies.

We also support the important revisions that have been proposed to the process for walkthroughs, the ability to rely on the work of others, and the ability to rely on procedures conducted in prior year audits. These changes, which we have encouraged the Board to undertake, also should significantly aid in streamlining the internal control audit process. See *Letter from Business Roundtable to PCAOB (May 5, 2006)*; *Letter from Business Roundtable to PCAOB (Nov. 26, 2003)* (copy attached).

While AS2 and the Proposal serve a purpose distinct from the recently proposed U.S. Securities and Exchange Commission (“SEC”) guidance on internal control evaluations, the interplay between these authorities is critical. Consequently, we encourage the Board to work with the SEC in adopting the Board’s final revision to AS2 so as to eliminate any inconsistent elements. For example, both the SEC guidance and the Proposal offer views as to indicators of material weaknesses. Specifically, the Proposal states that an ineffective internal audit function and risk

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assessment process are each strong indicators of a material weakness. The SEC guidance does not list these as examples of issues the SEC views to be strong indicators of material weakness. To avoid unnecessary confusion between management and auditors in assessing whether a control deficiency constitutes a material weakness, the examples of material weakness indicators should be harmonized in the SEC guidance and the Board's final internal control standard.

We also commend the Board for focusing on some of the important definitions in AS2 in its proposal. In particular, the proposed replacement of the term "more than inconsequential" with the term "significant" in the definition of "significant deficiency" provides a more appropriate threshold for evaluating deficiencies. We believe this clarification will reduce the effort devoted to deficiencies that do not present a reasonable possibility of a misstatement.

Nevertheless, we believe that some of the other definitional changes proposed by the Board may not achieve their desired effect. Specifically, the Board proposes to replace the reference to "more than a remote likelihood" in the definitions of "material weakness" and "significant deficiency," with "reasonable possibility." We are concerned that this may not be sufficient to focus attention on those matters that are most likely to impact the financial statements. In this regard, the Board issued guidance in 2005 indicating that the "more than remote likelihood" standard is intended to mean the "reasonable possibility" of a material misstatement (in the case of a material weakness) or a misstatement (in the case of a significant deficiency). Notwithstanding this guidance, in practice, the threshold at which material weaknesses are identified has still been applied in a very restrictive manner. Thus, we believe that consideration should be given to whether a higher threshold than "reasonable possibility," such as "more likely than not," would more appropriately focus the auditor's attention on the matters that are most likely to impact the financial statements.

Finally, in order for these proposed changes to succeed in making the internal controls process more efficient and effective, auditors must be assured that they will be incorporated into the Board's inspection process. Without assurance that the Board's inspection process will take into account the new auditing standard immediately upon its adoption, auditors will be less inclined to change their procedures. Accordingly, we urge the Board to incorporate into its final standard assurance that the inspection process will align with the new audit standard.

We appreciate the opportunity to present our views on this subject. We want to express our continued support for the underlying premise of Section 404 – effective internal controls. The suggestions we have outlined are designed to enhance the efficiency and effectiveness of the Section 404 process, while still preserving the benefits Congress intended.

Please do not hesitate to contact Thomas Lehner, Director of Public Policy at Business Roundtable at (202) 872-1260 if we can provide further information.

Sincerely,



Ms. Michele L. Cahn Peters
Vice President-External Affairs
Xerox Corporation
Chair, Corporate Governance Coordinating Committee
Business Roundtable

Attachments

cc: Mr. Mark Olson, Chairman, PCAOB
Ms. Kayla J. Gillan, Member
Mr. Daniel L. Goelzer, Member
Mr. Bill Gradison, Member
Mr. Chales D. Niemeier, Member



Business Roundtable

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BY EMAIL

November 26, 2003

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

Philip M. Condit
The Boeing Company
Chairman

Henry A. McKinnell, Jr.
Pfizer
Co-Chairman

Edward B. Rust, Jr.
State Farm
Co-Chairman

John J. Castellani
President

Patricia Hanahan Engman
Executive Director

Re: *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:

The following comments are submitted on behalf of the Business Roundtable, an association of chief executive officers of leading corporations with a combined workforce of more than 10 million employees in the United States and \$3.7 trillion in annual revenues. The Business Roundtable strongly supported enactment of the Sarbanes-Oxley Act of 2002 (the “S-O Act”), and we support the efforts of the Public Company Accounting Oversight Board (the “Board”) to implement the S-O Act. We appreciate the opportunity to provide you with our views on the Board’s recent proposed auditing standard, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements* (the “Proposed Standard”).

Scope of the Proposed Standard

Under Section 404 of the S-O Act (“Section 404”), management is required to prepare an internal control report that, among other things, is to include an assessment of the effectiveness of the internal control over financial reporting for the issuer. Section 404 separately requires a registered public accounting firm to “attest to, and report on, the assessment made by management of the issuer.” Although the statute envisions a discrete responsibility for the auditor under Section 404 – attesting to, and reporting on, management’s internal control assessment – the Proposed Standard appears to expand the scope of the auditor’s responsibility beyond that contemplated under Section 404. By proposing at the outset that the auditor’s attestation required under Section 404 be characterized as “an integrated audit of the financial statements and internal control over financial reporting,” we believe that the Proposed Standard proceeds from an incorrect premise.

To fulfill Congress's mandate under Section 404, an auditor clearly needs to perform sufficient attest procedures to reach a conclusion regarding management's own assessment and evaluation of the issuer's internal control over financial reporting. These attest procedures need to be robust and aligned with the scope of the auditor's responsibility under Section 404. However, by proposing that the auditor conduct an audit of the internal control over financial reporting, the Proposed Standard embraces a level of testing that is more extensive than that contemplated under the statute. If Congress had intended the auditor to conduct a full-blown audit of an issuer's internal control over financial reporting, it would have expressed such intent by using the term "audit" rather than "attest," and it would have made clear that the scope of such "audit" extended to the entirety of the issuer's internal control over financial reporting and not just management's assessment of this function. Accordingly, we urge the Board to revisit the scope of the Proposed Standard.

In addition to our concerns around the scope of the standard, we believe that the standard as currently drafted, does not permit an auditor enough latitude to exercise its judgment with respect to what is an appropriate level of testing for the specific company. In companies that have strong control environments, routine transactional processing should only require a minimal amount of detailed testing of the controls. Further, the amount of detailed testing should vary by not only the type of transaction stream, but also by the auditor's judgment as to the risk of a material weakness or significant deficiency based on the control environment, including external factors. For example, the payroll cycle would have regular checks by employees and tax regulators, and therefore, an auditor might deem most of the risk to come from unauthorized people being paid and focus detailed testing on that area. In addition, we believe that auditors should be permitted to vary the level of testing from year to year based upon whether there have been changes in the documented controls.

Finally, we believe that a standard that more appropriately focuses on the significant issues around business risk, fraud prevention and detection would better serve the needs of investors rather than the very prescriptive detailed testing approach in the Proposed Standard.

Using the Work of Management and Others

The Proposed Standard sets forth several principles that limit the ability of the auditor to rely on the work of management and others in conducting the required attestation. Specifically, the Board proposes to prohibit reliance on the work of management and others when the internal controls at issue relate to the prevention or detection of fraud that is reasonably likely to have a material effect on the issuer's financial statements and to restrict reliance where the internal controls relate to non-routine transactions. Reliance is essentially only unfettered where the controls relate to routine processing. In addition, the proposal requires that the auditor's own work, on an overall basis, form the basis for the required attestation.

These proposed restrictions may have been suitable if the proposal were being adopted as a stand-alone effort to enhance internal control over financial reporting, but it is not. The S-O Act and the rules adopted by the U.S. Securities and Exchange Commission (the "SEC") to implement Section 404 already bolster the internal control over financial reporting function. Under Section 404, management is required to design and evaluate the effectiveness of the internal control over financial reporting, to prepare an annual report evaluating this function, and to certify as to the effectiveness of these internal controls. Our members and their financial and accounting teams take these new obligations very seriously. The proposed restrictions on the auditor's ability to rely on the work of management and others give insufficient credit to the significant steps that issuers are taking to comply with the Section 404 requirements.

Rather, the Proposed Standard would require auditors to develop and obtain separate and extensive evidence about whether the internal controls are effective. Consistent with the statutory requirement that the auditor attest to management's evaluation of these controls, the auditor should be able to exercise its judgment in deciding whether to rely on management's or others work with respect to the entire range of internal controls, not simply controls for routine processes. This approach will eliminate duplicative, unnecessary testing that would increase issuers' costs significantly with only questionable benefit, if any, for investors.

The final standard also should reflect attestation procedures that allow auditors to place greater reliance on testing performed by internal auditors. The internal audit function is set up to serve as a separate check on the financial reporting process in addition to the work performed by the external auditor. Yet, the Proposed Standard subjects the work performed by internal audit to the same proposed guidelines for reliance to which others within an issuer organization would be subjected. The final standard should allow an auditor to place greater reliance on work performed by internal audit where the outside auditor views the internal auditor to be sufficiently independent and competent.

Accordingly, the final standard should allow the auditor greater flexibility in determining whether to place reliance on the work performed by management and others within the issuer, including, in particular, the internal audit function.

Evaluation of the Effectiveness of the Audit Committee

The Proposed Standard provides that the auditor should evaluate the effectiveness of the audit committee's oversight of the company's external financial reporting and internal control over financial reporting as part of its attestation requirements. The Board proposes that this evaluation should include, among other things, review of the audit committee's independence from management, compliance with applicable listing

standards, and the level of involvement and interaction with the auditor (including the committee's role in appointing, retaining and compensating the independent auditor).

We believe that this proposed requirement is particularly inappropriate given the audit committee's direct responsibility for the appointment, compensation, retention and oversight of the registered public accounting firm under Section 301 of the S-O Act and implementing SEC and securities markets rules and listing standards. By creating a dual evaluation standard for the auditor and audit committee, the proposal would establish a clear conflict of interest. Moreover, the audit committee has responsibilities that go well beyond those in which it interacts with the external auditor, and the auditor does not have any particular expertise with respect to such issues as the independence of individual audit committee members from management. Accordingly, we believe that this aspect of the proposal is ill-conceived, and we urge the Board to eliminate it.

Definitional Issues

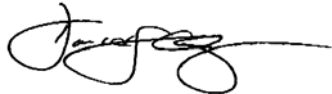
We have additional concerns about certain of the definitional aspects of the Proposed Standard. First, the Board proposes a "more than remote likelihood" standard to evaluate whether a deficiency rises to the level of a "significant deficiency" and whether a significant deficiency rises to the level of a "material weakness." This proposed standard creates an unreasonably low threshold for placing a purported deficiency into the "significant deficiency" category and for placing a purported "significant deficiency" into the "material weakness" category. We believe the current standard for determining whether the control component reduces to "a relatively low level" the risk of misstatement is more appropriate for each of these definitions, and we urge the Board to adopt this standard.

Second, the definition of "significant deficiency" also includes the concept that the deficiency at issue must be one that results in an inability to prevent or detect fraud that results in a misstatement that is more than "inconsequential in amount." It is unclear what this phrase is intended to mean; more than "inconsequential in amount" could mean relatively de minimis amounts to any given issuer. This construction could lead to the reporting of deficiencies that are by no means material, simply because they represent a perceived, consequential dollar amount. We therefore also urge the Board to replace this vague construction with a "materiality" concept, which has a more familiar and developed meaning under the securities laws.

* * *

We appreciate your consideration of these comments, and we would be happy to discuss these matters further or to meet with you if it would be helpful.

Sincerely,

A handwritten signature in black ink, appearing to read "David L. Shedlarz", with a long horizontal flourish extending to the right.

David L. Shedlarz
Executive Vice President & CFO
Pfizer Inc.
Chairman-Principle Financial Officers Subcommittee
Corporate Governance Coordinating Committee
Business Roundtable

cc: William J. McDonough, Chairman
Kayla J. Gillan, Member
Daniel L. Goelzer, Member
William Gradison, Member
Charles D. Niemeier, Member



Business Roundtable

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May 5, 2006

VIA FACSIMILIE

Public Company Accounting Oversight Board
Attention: Office of the Secretary
1666 K Street, N.W.
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Henry A. McKinnell, Jr.
Pfizer Inc
Chairman

Kenneth I. Chenault
American Express
Company
Co-Chairman

Edward B. Rust, Jr.
State Farm Insurance
Companies
Co-Chairman

John J. Castellani
President

Larry D. Burton
Executive Director

Johanna I. Schneider
Executive Director
External Relations

Re: Internal Control Roundtable

Dear Public Company Accounting Oversight Board:

This letter is submitted on behalf of Business Roundtable, an association of chief executive officers of leading corporations with over \$4.5 trillion in annual revenues and more than 10 million employees. Business Roundtable strongly supported the enactment of the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley), as well as the efforts of the Securities and Exchange Commission (SEC) to implement Sarbanes-Oxley.

We are all in agreement that, in the wake of Enron, Worldcom and several other high-profile corporate scandals, Congress needed to act to restore the integrity of financial reporting. One of the critical measures Congress enacted as part of Sarbanes-Oxley was Section 404, relating to internal controls. The Roundtable companies have embraced Sarbanes-Oxley, including Section 404, and the revised listing standards, and have used the opportunity to improve their corporate governance and their internal controls over financial reporting. The result has been -- as Congress intended -- improved investor confidence in our capital markets.

Now that we have gone through another cycle of the Section 404 process, it is a good opportunity to address implementation issues. Thus, we applaud the SEC for convening the roundtable on May 10, 2006 to reflect on the Section 404 implementation process for the second year in a row. In implementing Section 404 and its related rules, including, in particular, the PCAOB's Auditing Standard No. 2, it continues to be clear that the benefits of Section 404 do not always outweigh the burdens. In this letter, we would like to outline some of the challenges that Section 404 continues to present and offer some suggestions to the SEC and PCAOB with respect to Auditing Standard No. 2.

To be clear, we want to express our continued support for the underlying premise of Section 404 -- effective internal controls over financial reporting. However, as we indicated at the 2005 Section 404 Roundtable, there are steps that the SEC and the PCAOB can take to make the Section 404 process more effective and efficient, while still preserving the benefits Congress intended.

We appreciate the constructive statements in the guidance documents provided last summer by the SEC and the PCAOB, but we believe that more needs to be done to streamline the Section 404 process (see Commission Statement on Implementation of

Internal Control Reporting Requirements, May 16, 2005; Staff Statement on Management's Report on Internal Control over Financial Reporting, May 16, 2005; and PCAOB Release No. 2005-009, Policy Statement Regarding Implementation of Auditing Standard No. 2, An Audit of Internal Control over Financial Reporting Performed in Conjunction with an Audit of Financial Statements, May 16, 2005). We are concerned that, against the tremendously detailed backdrop of the text of Auditing Standard No. 2 itself, the guidance offered in these releases last summer has not been sufficiently embraced. Accordingly, we think an actual amendment of Auditing Standard No. 2 is necessary to bring about effective and efficient implementation to diminish the Section 404 process. Among the topics to be addressed, which we noted in our statement filed on April 7, 2005, are:

- A Change in Tone: Encourage the auditor to exercise greater professional judgment in the internal control process.
- The Definition of Significant Deficiency: The definition in Auditing Standard No. 2 should be modified to reflect a reasonable assurance standard under which public companies and their auditors will focus on concerns that actually may impact financial reporting and thus are of concern to the investing public.
- Limit Walkthroughs: Propose that the independent auditor may use its professional judgment to conduct walkthroughs for only a random sampling, rather than all, of the major classes of transactions in any given audit year.
- Reliance by Auditors on Work of Others: Clarify that the independent auditor is encouraged to exercise its professional judgment and rely on the work of others, particularly a company's internal audit function, as principal evidence where the independent auditor has considered and reasonably tested the competence, objectivity and independence of those on whom it seeks to rely.

We appreciate the opportunity to present our views on this subject. The suggestions we have outlined are designed to enhance the efficiency of the Section 404 process and Auditing Standard No. 2, while retaining the most important benefit – effective internal controls.

Sincerely,



David Fannin
General Counsel, Office Depot, Inc.
Chairman, Coordinating Committee,
Corporate Governance Task Force Business Roundtable

cc: Mr. Bill Gradison, Acting Chairman, PCAOB