

November 18, 2003

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

RE: Invitation to Comment on PCAOB Rulemaking Docket Matter No. 008

Dear PCAOB:

I wish to comment on the proposed auditing standard, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction With An Audit of Financial Statements*.

My comments are limited to three issues:

- a) **your question 1:** use of the phrase “audit of internal control over financial reporting”
- b) **your question 27:** wording in the non-standard opinion paragraph; and
- c) **general:** your use of the phrase “fairly stated in accordance with generally accepted accounting principles”

(a) Use of the phrase “audit of internal control over financial reporting”

Those involved in accounting, financial reporting and auditing will easily understand this phrase. However, for those not directly involved, its similarity to the phrase “audit of financial statements” is potentially problematic. I include in this possibly confused group readers and analyzers of financial statements, as well as representatives of the media.

My concern is that well meaning people will be speaking or writing about one of these audits (say, financial statements) to listeners who may be thinking about the other (say, internal control). This confusion would be ironic considering that transparency is probably the most desired outcome of Sarbanes-Oxley.

It would not be practical to change the long-standing phrase “audit of financial statements.” We are left then to find a substitute for “audit of internal control over financial reporting.” I suggest the following phrase: “independent assessment of internal control over financial reporting.”

Furthermore, I note that the title of each of your example reports (A-1 through A-6) is “Independent Auditor’s Report.” I see this as another source of confusion. In my view, “Independent Auditor’s Report” is much too associated with the audit of financial statements to use it in any other context.

(b) Wording in the non-standard opinion paragraph

Your proposed wording in a non-standard opinion speaks directly to the effectiveness of the internal control over financial reporting rather than to whether management's assessment is fairly stated.

I suggest that we use the non-standard audit opinion on financial statements as a guide to evaluate your proposed wording.

- If the auditor concludes that financial statements are fairly stated, the opinion so indicates.
- If an adverse opinion is to be expressed, the opinion expressed is: "... the financial statements ... are not fairly stated."

Your suggested wording for an unqualified opinion re: internal control over financial reporting is as follows:

- "...management's assessment that Company W maintained effective internal control ... is fairly stated."

To be consistent with the financial statement audit approach, the logical counterpart when an adverse opinion is to be expressed should be as follows:

- "...management's assessment that Company W maintained effective internal control ... is not fairly stated."

Also, it is important to note that your suggested wording of "... has not maintained effective internal control ..." is not consistent with the introductory paragraph's claim that "... our responsibility is to express an opinion on management's assessment."

(c) Use of the phrase "fairly stated in accordance with generally accepted accounting principles"

Under Section 302 of Sarbanes-Oxley, CEO and CFO certifications include that:

"... financial information ... fairly presents the financial condition, results of operations and cash flows."

In my view, it is notable that, in this certification, fair presentation is not modified by "in accordance with generally accepted accounting principles." I believe that this is not an accidental omission - I assume that it is an intentional clarification (by omission) that GAAP compliance does not necessarily result in fair presentation.

But, paragraph 6 of your proposed standard refers to "... preparation of financial statements ... in accordance with generally accepted accounting principles..." It seems to me that the PCAOB (and the SEC) needs to decide exactly what role GAAP compliance should play in this new reporting environment. Failure to spell this out seems, in my opinion, to be quite unfair to CEOs, CFOs, preparers, audit committees and auditors.

As a sidebar, the standard audit report on financial statements refers to the source of GAAP and generally accepted auditing standards. This recognizes both the global nature of the reporting environment and fast developing international standards. I suggest that your references to GAAP or GAAS be specific (for example, US-GAAP) or that, through footnote(s), you explain the role, if any, of non-US sources of GAAP and GAAS.

Yours truly,

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