MGIC Investment Corporation

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

Re: PCAOB Rulemaking Docket Matter No. 008

We are pleased to comment on the proposed auditing standard - *An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements* proposed in PCAOB Release No. 2003-017. We are only responding to those questions asked by the PCAOB within Release No. 2003-017 that we have substantive comments on.

<u>Questions</u>

#10 - Is it appropriate to require that the walkthrough be performed by the auditor himself or herself, rather than allowing the auditor to use walkthrough procedures performed by management, internal auditors, or others?

#12 - To what extent should the auditor be permitted or required to use the work of management and others?

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

#14 - Does the proposed standard give appropriate recognition to the work of internal auditors? If not, does the proposed standard place too much emphasis and preference on the work of internal auditors or not enough?

<u>Comments</u>

- Paragraph 104 of the proposed standard states that the auditor should not use the results of testing performed by management and others for the following areas: 1) controls that are part of the control environment; 2) controls over the period-end financial reporting process; 3) controls that have a pervasive effect on the financial statements, such as certain information technology general controls, on which the operating effectiveness of other controls depend; and 4) walkthroughs. We believe that auditors should be allowed to use the results of others (especially internal auditors) in these areas, the extent of which would be based on an evaluation of the factors included in paragraph 103 of the proposed standard. In addition, paragraph 103 should be expanded to include an evaluation of the competence and independence of the party performing the testing.

- We believe that the areas defined in paragraph 104 are significant areas requiring extensive auditing procedures. Providing auditors with no flexibility in using the work of others in these areas may lead to excessive auditing costs.

- Other than the above comments, we believe paragraph 108 of the proposed standard provides proper recognition to the work of internal auditors.

- We believe that the Board should clarify the requirement in paragraph 109 that states "the auditor must perform enough of the testing himself or herself so that the auditor's own work provides the principal evidence for the auditor's opinion" (e.g., greater than 50%).

Question

#11 - Is it appropriate to require the auditor to obtain evidence of the effectiveness of controls for all relevant assertions for all significant accounts and disclosures every year or may the auditor use some of the audit evidence obtained in previous years to support his or her current opinion on management's assessment?

Comments

We believe that the auditor should be allowed to use risk assessment to determine whether controls for all relevant assertions for all significant accounts and disclosures should be evaluated every year. We do not believe that all significant accounts and disclosures should be treated equally. Controls associated with certain accounts and disclosures may require annual assessment based on the potential risk of misstatement; however, we believe that other controls may not require annual assessment based on an evaluation of certain risk factors, such as the risk of misstatement, the results from prior assessments, changes in control procedures and personnel since the last assessment, and whether the control is routine/systematic. We believe requiring testing of controls for all relevant assertions for all significant accounts may be unnecessary and may lead to unnecessary auditing procedures and related auditing costs.

Questions

#17 - Will the definitions in the proposed standard of significant deficiency and material weakness provide for increased consistency in the evaluation of deficiencies? How can the definitions be improved?

#20 - Is it appropriate to require the auditor to communicate all internal control deficiencies (not just material weaknesses and significant deficiencies) to management in writing?

#22 - Is it appropriate to require the auditors to evaluate the effectiveness of the audit committee's oversight of the company's external financial reporting and internal control over financial reporting?

#23 - Will auditors be able to effectively carry out their responsibility to evaluate the effectiveness of the audit committee's oversight?

Comments

- We believe that it is important for the standard to provide definitions that will lead to increased consistency in the evaluation of deficiencies. We also agree that the significance of a deficiency should be evaluated based on the potential "likelihood" of a misstatement and the potential "amount" of a misstatement. However, we believe that the definitions included in the proposed standard set the bar too low for determining whether a deficiency is a significant deficiency or material weakness. We specifically disagree with the use of "more than a remote likelihood" in the definitions of significant deficiency and material weakness, and the use of "more than inconsequential in amount" in the definition of significant deficiency. For a deficiency to be considered significant or material, we believe that the potential likelihood of a material misstatement should be significantly more than remote (e.g., likely or probable). We also believe that for a deficiency to be considered significant, the potential misstatement should be significantly more than inconsequential in amount (e.g., significant).

- Based on these current definitions, we believe that it could be misleading to investors if management is required to conclude that controls are not effective and auditors are required to issue an adverse opinion when a single material weakness exists. This could lead to an unnecessary decline in shareholder value.

- We do not believe that auditors should be required to report all internal control deficiencies to management in writing. We believe that reporting of significant deficiencies and material weaknesses in writing is sufficient. Communication of deficiencies between management and the auditor should focus on significant matters so that management understands what is important and what should be corrected in a timely manner. The auditor should be allowed to communicate lower risk deficiencies verbally, or in some cases be able to pass on small matters entirely. If reported in writing, management may feel compelled to correct all deficiencies reported, even though certain deficiencies may not warrant correction based on a low level of risk and the costs required to correct the deficiency.

- We believe that the auditor may have difficulty conducting an unbiased, effective evaluation of the audit committee since the auditor is directly accountable to the audit committee.

Additional Comments

- Appendix B of the proposed standard addresses situations when a company uses a service organization. We believe that obtaining evidence regarding the effectiveness of internal controls over financial reporting at service organizations will present a significant challenge to companies and their auditors. Many service organizations may not have a service auditor's *report on controls placed in operation and tests of operating effectiveness* available, or the report may not be available prior to the date of management's report on internal control over financial reporting. Requiring companies to perform tests of controls at service organizations will place significant burdens on companies and their auditors, and on the service organizations themselves.

- Another concern relates to how a company should report a material weakness at a service organization. Is it reasonable for a company to be required to conclude that their internal control over financial reporting is not effective due to a material weakness at a service organization that they have no direct control over? Will all clients of that service organization be required to come to the same conclusion? What if one client of the service organization discovers the weakness during their test procedures but another client does not, resulting in inconsistent assessments? We believe the Board should reconsider its position regarding a company's and its auditor's responsibilities for assessing controls at a service organization.

I would be happy to discuss these comments with the Board and can be reached at 414-347-6918.

Very truly yours,

Gary A. Antonovich