

November 14, 2003

**James P. Gulick**  
Senior Vice President  
General Auditor

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

Reference: Rulemaking Docket Matter No. 008

Gentlemen:

We are pleased to submit our comments on the proposed auditing standard over the examination of internal controls. Having reported under the requirements of the Federal Deposit Insurance Corporation Improvement Act for the past 10 years, we understand the breadth and depth necessary to document and test an internal control environment. Our overall sense of the proposed auditing standard is that it is very comprehensive and should result in improved documentation and operation of internal controls. The focus of our comments in this letter are on the testing of controls, the use of internal audit, and the extent of documentation and testing required of the external auditor. The responses are organized using the questions outlined in the exposure draft.

**Q.9 Are the objectives to be achieved by performing walkthroughs sufficient to require the performance of walkthroughs?**

**Q.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?**

We believe the use of a walkthrough is a critical step to ensure that controls are properly understood and documented. This step has been a requirement of our internal audit process for many years and is effective in ensuring that the internal control system is accurately documented. We believe the requirement for the external auditor to directly perform the walkthrough test in order to comply with the auditing standard is excessive and unnecessary. Presuming the Corporation has an effective internal audit group and conforms to professional standards such as those published by the Institute of Internal Auditors, the internal auditors' working papers will contain system documentation, walkthrough testing, and audit testing of the controls. Further, management will also have documentation of its control system. The external auditor should be able to obtain sufficient satisfaction with the documentation of the control system by reviewing said documentation and the results of both the walkthrough and audit testing performed by internal audit and reperforming a sample, as is currently required under SAS 65. Presuming the results of those tests are adequate, the reperformance of every walkthrough is redundant. Further, as the years pass by, the walkthrough becomes redundant for internal control systems that do not change. Thus, the mandate for a walkthrough every year by the outside auditor is cost inefficient as well. We believe the walkthrough should be required to be performed by the

outside auditor only on a test basis or in those circumstances where the auditor's reliance on the work performed by internal audit cannot be comfortably attained, or the outside auditor believes there are weaknesses in the control system or inaccuracies in the documentation.

**Q.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?**

**Q.12 To what extent should the auditor be permitted or required to use the work of management and others?**

Clearly the external auditor needs to perform enough work to satisfy himself that controls are in existence and operating during the period under audit. Thus, some level of new testing will be required every year. However, for control systems that do not change significantly from year to year, the external auditor will have developed a foundation upon which he can build his audit testing in the subsequent year. The auditor should be given the flexibility to rely on prior year systems documentation, walkthrough testing, and the results of prior year testing to determine the extent of testing needed in the current year. If an internal audit department is performing ongoing testing and assessment of internal controls, the external auditor should have the flexibility to rely on that work to reduce the amount of new testing required in any year. This would include providing the external auditor the ability under the rules to determine that no new original testing need be performed by the external auditor if he is totally satisfied with the results of the internal auditing and the system documentation that exists. Generally speaking, this reliance should be based upon a positive result of a continuous monitoring program that the internal audit department is independently performing over the control environment.

In order to form an opinion on the internal control system, some level of independent testing is necessary. For a corporation where internal audit activity is minimal or non-existent, the external auditor would need to perform extended testing in order to gain the appropriate coverage and comfort over the control environment. Clearly, any management testing that is performed can be tested by the external auditor and serve to reduce the overall testing level of the external auditor if the management testing is determined to be accurate. However, given that management is responsible for the operation of the controls, sufficient independent testing is appropriate. However, for organizations that have invested in a competent internal audit department with robust internal audit testing, the external auditor should be able to limit his work by testing the work of the internal audit department. The internal auditor is already charged with providing an independent assessment of the operation of the internal controls. Thus, the external auditor should be able to rely upon that work to limit and reduce the level of original work performed by the external auditor. Ultimately, the external auditors extensive original testing should be focused on potential weaknesses in the control system or areas where management or the internal audit department have not performed adequate testing.

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

While the intent of the audit standard appears to be giving the external auditor some flexibility, there are certain phrases in the standard that are confusing and somewhat contradictory, as follows:

- Paragraph 104, bullet 1 states that “...the auditor should not use the results of testing performed by management and others, including **controls that are part of the control environment...**” This statement is confusing. It would appear this bullet is intended to be the counterpart to paragraph 105, bullet 2 where the auditor has the option to rely on the work performed by management or others for control areas that are deemed highly likely to operate effectively. While it is apparent that the objective is to provide an opportunity for the external auditor to utilize professional judgment, we aren’t sure how these two bullets working together provide a framework for the auditor to make a decision within the context of the audit standard.
- Paragraph 104, bullet 2 suggests the auditor “...should not use the results of testing performed by management and others, including controls over the period-end financial reporting process, including controls over procedures used to enter transaction totals into the general ledger; to initiate, record, and process journal entries in the general ledger; and to record recurring and non-recurring adjustments to the financial statements”. While the bullet gives an example referring to consolidating adjustments and report combinations, the verbiage in this bullet can be deemed to refer to all controls for systems that generate mechanized journal entries in support of the general ledger up through the financial reporting process. The bullet does not seem to be restrictive as suggested in the example. Thus, the interpretation of this bullet would suggest the outside auditor could not use the work of others in evaluating controls that result in general ledger entries to record transactions, even though they are routine. This also seems to be in conflict with the item discussed in the previous bullet in this letter.
- Paragraph 104, bullet 3 suggests that the outside auditor cannot rely on any information technology controls that are tested by management or internal auditors. While we acknowledge the critical nature of the information technology control environment, we believe that there are many routine processes within these controls where management or the internal auditors ability to examine these controls is sufficient. The external auditor should have the opportunity to place reliance on the internal audit testing of information technology controls just as it does for non-technology controls.

The proposed audit standard indicates early on that the assertion by the external auditor as to management’s assessment of internal controls is equivalent to the external auditors testing of those controls. While we accept and acknowledge that statement, paragraphs 104-106 seem heavily focused on the independent testing of the individual controls. We believe that the external auditor should start from the premise that they are testing management’s control evaluation process and that the testing of the auditor should be determined by its ability to gain comfort with management’s process. We believe that an audit approach can easily and

reasonably be developed where the external auditor can conclude that management's process is effective without the need for extensive new auditing. The auditor should be permitted to start from the "top down" and drill through management's process until they reach a point that they can conclude upon management's assertion, which is equivalent to issuing their own opinion on the system of internal controls. Paragraphs 104-106 suggest that the external auditor is auditing from the "ground up" which in many cases will result in redundant and costly testing to reach the same result.

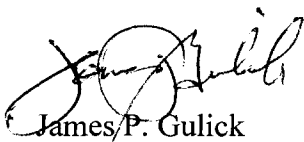
**Q.14 Does the proposed standard give appropriate recognition to the work of internal auditors? If not, does the proposed standard place too much emphasis and preference on the work of internal auditors or not enough?**

**Q.16 Is the requirement for the auditor to obtain the principal evidence, on an overall basis, through his or her own work the appropriate benchmark for the amount of work that is required to be performed by the auditor?**

We believe that the proposed standard does not permit enough emphasis to be placed on the work of internal audit. The auditor's report will focus on management's assertion. Therefore, the preponderance of evidence for the operation of the control environment should rely with management and with management's testing. Only in the case of weak controls or insufficient testing should the external auditor be required to provide the preponderance of evidence to support its audit opinion. These statements presume that the external auditor can obtain a high degree of comfort with the work performed by the internal audit department. The process of documenting and testing the control environment is a time-consuming and costly process. Companies that make the investment in a competent internal auditing department with a robust audit program should be rewarded for that effort by permitting reliance on that work by the external auditor. Alternatively, companies that do not make such an investment should be subjected to intense auditing by the external auditor in order to support management's assertion as to the operation of its control environment. An internal audit department is very likely to have a much more in-depth understanding of a company's operations and controls and therefore its testing should provide a strong foundation upon which the external auditor can rely. While the tone and specific paragraphs of the proposed audit standard suggest flexibility on the part of the external auditor, there is still an obvious requirement that the external auditor perform robust original auditing to support its conclusion. Again, we believe that in situations where controls are strong, documented, and tested that this is a redundant and cost inefficient requirement.

We thank you again for the opportunity to comment on the proposed auditing standard. Please call 216-222-2000 if you would have questions on our comments in this letter.

Sincerely,



James P. Gulick  
Senior Vice President  
General Auditor