SOUTHERN UNION COMPANY
ONE PEI CENTER
WILKES-BARRE, PA 18711

November 21, 2003

Re: PCAOB Rulemaking Docket Matter No. 008

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

Dear Secretary:

This letter is in comment to PCAOB Rulemaking Docket Matter No. 008 (the "Proposed Standard") concerning the proposed auditing standard on an audit of internal control over financial reporting performed in conjunction with an audit of financial statements.

Section 404(a) of the Sarbanes-Oxley Act of 2002 (the "Act") requires that public company management annually assess and report on the effectiveness of the company's internal control over financial reporting. Section 404(b) of the Act requires registered public accounting firms to attest to, and report on, the assessment made by management. In an attestation engagement, auditors issue an examination, a review, or an agreed-upon procedures report on subject matter, or on an assertion about the subject matter, which is the responsibility of another party. Statements on Standards for Attestation Engagements No. 10 ("SSAE No. 10") identify certain engagements, such as a financial statement audit, that are not subject to the attestation standards.

The Proposed Standard mentions that the auditor's attestation of management's assessment of the effectiveness of internal control over financial reporting should be referred to as the "audit of internal control over financial reporting" as a financial statement audit is a form of attestation. This appears to contradict SSAE No. 10. The Act mandated that public accounting firms attest to management's assessment of internal controls over financial reporting. However, the Proposed Standard recommends an audit of internal control over financial reporting. The differences between an attestation engagement and an audit engagement differ significantly as to procedures, hours (both by management and public accounting firms) and cost. Despite the Proposed Standard's exceptional value in defining what an effective internal control environment over financial reporting should be, proposing an audit rather than an attestation will add extensive process and costs without adding corresponding value to shareholders. Please consider reducing the scope of the Proposed Standard from a detailed audit to an attestation/review of management's assertions, while maintaining the overall objective for public companies to have effective internal controls over financial reporting.

The Proposed Standard also significantly limits the reliance of internal audit's work by public accounting firms. Such limitations will increase management's time and cost for reporting on the effectiveness of internal control over financial reporting. If public accounting firms are allowed to rely on work done by internal audit in a financial statement audit, it does not seem appropriate to exclusively require external auditors to perform certain testing of internal controls (i.e., such as the walkthroughs themselves). As with any work performed by internal audit in a financial statement audit, some level of review or sub testing would be performed by the external auditors on the internal auditor's work. As such, the Proposed Standard fails to recognize the value and competencies that an internal audit department provides to a company and management. The internal audit function should be considered one of the primary tools for maintaining and monitoring internal controls and, the external auditors should be allowed to utilize the assistance of internal audit throughout the external auditors engagement in attesting to management's assessment of internal controls over financial reporting.

In the Securities and Exchange Commission's ("SEC") open meeting on May 27, 2003, the SEC indicated that the effective date of the Section 404 compliance was extended in part to: (i) give public company management and their auditors time to gear up for the new requirements and (ii) to give the PCAOB additional time to develop its rules on the independent auditor's attestation report on management's assertions on the adequacy of internal control over financial reporting, and to consider whether additional standards or guidance are appropriate. However, those rules are not yet finalized. Our Company, Southern Union Company, has a fiscal year end of June 30th. The Proposed Standard has required the company to reassess the adequacy and deficiencies in it's current internal control documentation performed to date. When the final rules are issued this could require the company to make additional changes. Additionally, the company's external accountants cannot currently address certain questions concerning their testing of internal control over financial reporting concerning such items as sample sizes, how to define materiality, what is considered adequate documentation, etc. The external auditors have been able to provide us responses based on their interpretation of current proposed rules, but have mentioned that definite firm guidance will not be available until the rules are finalized.

Southern Union is concerned that the lack of final rules to date concerning internal controls over financial reporting may hinder the ability to adequately document, test, correct and allow for external auditor testing over such controls by June 30, 2004. It has been six months since the SEC allowed an extension of the effective date of Section 404 due to the various reasons previously mentioned, which have not been resolved to date. In order to give companies sufficient time to comply with the final rules of Section 404 of the Act, they should be given nine to twelve months from the date of the final rules until effective management reporting over internal controls is required. This would give management adequate time to implement the final rules so to correct current documentation, to retest controls as required and to give management's external auditors time to review and test changes. Additionally, companies' external auditors will need to develop firm policies and guidelines, communicate requirements to clients and require sufficient time in order to test controls identified as occurring only quarterly. The PCAOB should encourage the SEC to extend the effective date of Section 404 for at least another three months, assuming that the final rules are released within the next 30 to 60 days. Southern Union agrees that company management should annually assess and report on the effectiveness of the company's internal control over financial reporting and allow registered public accounting firms to attest to, and report on, the assessment made by management. We raise the following question: Without final guidance for both company management with June 30 year-ends and their external auditors, is adequate time being allowed to comply with Section 404 of the Act?

Under the previously mentioned Proposed Standard, the following questions were asked in which I would like to respond to:

1. Is it appropriate to refer to the auditor's attestation of management's assessment of the effectiveness of internal control over financial reporting as the audit of internal control over financial reporting?

    Response: No. I would suggest "the attestation review of management's annual assessment of internal control over financial reporting." In an attestation (or "attest" as used in the Act), the emphasis and focus on documenting and testing the system of internal controls over financial reporting should be on management of the company only. The auditor should then reperform some of management's test on a sample basis to obtain sufficient evidence that controls are operating as documented by management. An attestation review places the primary burden and cost of assessing the system of internal controls on management and not both management and their external auditor.

2. Should the auditor be prohibited from performing an audit of internal control over financial reporting without also performing an audit of the financial statements?

    Response: The knowledge gained in the financial statement audit should improve the nature of the auditor's attestation review of management's annual assessment of internal control over financial reporting. Additionally, it appears that Section 404(b) of the Act intended that the external auditor should be prohibited from performing an attestation of internal control over financial reporting without also performing an audit of the financial statements. Section 404(b) states that "each registered public accounting firm that prepares or issues the audit report for the issuer shall attest to, and report on, the assessment made by the management of the issuer…Any such attestation shall not be the subject of a separate engagement."

3. Rather than requiring the auditor to also complete an audit of the financial statements, would an appropriate alternative be to require the auditor to perform work with regard to the financial statements *comparable to* that required to complete the financial statement audit?

   Response: This would be an appropriate alternative. Please also see the response to question number 2.

4. Does the Board's proposed standard give appropriate consideration to how internal control is implemented in, and how the audit of internal control over financial reporting should be conducted at, small and medium-sized issuers?

   Response: No. No specific guidance or quantification is provided to define small and medium-sized issuers. Such measurements could include revenues, market capitalization, total assets, or number of employees involved in the financial aspect of internal controls. Additionally, consideration should be given to how internal control is implemented and conducted at companies that are highly regulated such as utilities, interstate pipelines and banks, which are subject to periodic audit, review and inspection of their financial information by regulators.

5. Should the Board, generally or in this proposed standard, specify the level of competence and training of the audit personnel that is necessary to perform specified auditing procedures effectively? For example, it would be inappropriate for a new, inexperienced auditor to have primary responsibility for conducting interviews of a company's senior management about possible fraud.

   Response: The level of competence and training of the external audit personnel that is necessary to perform the attestation procedures over internal controls over financial reporting should be specified in the Proposed Standard. It appears that external audit firms have swung back and forth over time concerning the level of documentation and testing of internal controls that have been performed in financial statement audits, which brings into question the level of experience and competency that external audit staff have with respect to assessing the effectiveness of internal controls. External audit members at all levels should only be assigned tasks for which they are sufficiently competent.

6. Is the scope of the audit appropriate in that it requires the auditor to both evaluate management's assessment and obtain, directly, evidence about whether internal control over financial reporting is effective?

   Response: The Proposed Standard concerning the auditor's attestation of management's assessment of the effectiveness of internal control over financial reporting currently recommends that such engagement be referred to as the "audit of internal control over financial reporting." The Act as

enacted by Congress utilized the wording of "*attest to*, and report on, the assessment made by the management of the issuer." Consideration should be given to the original intent concerning the auditor's attestation of management's assessment of the effectiveness of internal control over financial reporting of the Act as an attestation and not an audit, while maintaining the overall objective for public companies to have effective internal controls over financial reporting.

7. Is it appropriate that the Board has provided criteria that auditors should use to evaluate the adequacy of management's documentation?

    Response: It is appropriate for the Board to provide criteria that auditors should use to evaluate the adequacy of management's documentation, but additional guidance is necessary. Guidance should consider such items as the size of the company, nature of the company's operations, complexity of the system of internal control, management involvement in the operations of the business, quality of company employees, etc. Not all types of documentation involved in maintaining internal controls at companies are equally important. If adequate documentation is considered important in the determination of internal control evaluation, the lack of documentation would be costly and time consuming to remediate in order to ensure timely compliance with Section 404 of the Act. General references to "lack of documentation" are subject to many interpretations and therefore it is imperative that such criteria are specific and interpreted consistently. Additionally, excessive documentation "just for the sake of having documentation" could be expensive and provide both management and shareholders little to no value.

8. Is it appropriate to state that inadequate documentation is an internal control deficiency, the severity of which the auditor should evaluate? Or should inadequate documentation automatically rise to the level of significant deficiency or material weakness in internal control?

    Response: I would answer no to both of these questions. Documentation will vary by company considering, among other things, the size of the company, the complexity of the systems and the experience of company employees documenting the systems. Unless you have the same external auditors review the documentation of each entity, what may be inadequate documentation for one accounting firm may not be inadequate to another. No standard or guidelines are provided as to what is adequate considering the numerous factors that may be present within a company that determines the extent of their documentation. As currently considered, measuring the adequacy of the documentation is too subjective. It is possible to have a strong system of internal controls over financial reporting but not have adequate or appropriate written documentation. Please also see the response to question number 7.

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

   Response: Yes. Walkthroughs allow an individual to obtain an understanding of the various financial processes and helps an individual to identify key control aspects of a process.

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?

    Response: No. If auditors can rely on work done by internal audit, management and others in a financial statement audit, it does not seem appropriate to exclusively require auditors to perform the walkthroughs themselves. As with any work performed by internal audit in a financial statement audit, some level of review or sub testing would have to be performed by the external auditors on any others work done in this area.

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?

    Response: It should be appropriate in certain instances to allow the external auditor to utilize portions of their evidence of the effectiveness of controls obtained in previous years. Once the effectiveness of a control has been tested, the external auditor should be allowed in future years to determine if circumstances surrounding this control have changed, and than to determine the level and extent of testing on such control for that year. For example, if certain information technology application controls were tested and deemed to be effective in the preceding year and appropriate controls are in place over the application development and maintenance function, a review of the particular application's controls in the current year should be limited to those application controls impacted by programming changes, if any.

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

    Response: Please see the response to questions number 10 and 14. The external auditors should be allowed to utilize the assistance of internal audit throughout the external auditors engagement in attesting to management's assessment of internal controls over financial reporting, as long as any work performed by internal audit is reviewed or retested on a sample basis by the external auditors.

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

    Response: The three categories of controls as presented in the Proposed Standard are appropriately defined. The Proposed Standard though mentions that no reliance should be placed on the work of others for controls such as those specifically intended to prevent or detect fraud. As previously mentioned, the external auditors should be allowed to utilize the assistance of internal audit for this category of controls as well as the other categories.

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?

    Response: No. There is not enough recognition in the Proposed Standard of the value and competencies that an internal audit department provides to a company and management. The internal audit function should be considered one of the primary tools for maintaining and monitoring internal controls. The external auditors should be allowed to utilize the assistance of internal audit throughout the external auditors engagement in attesting to management's assessment of internal controls over financial reporting.

15. Is the flexibility in determining the extent of reperformance of the work of others appropriate, or should the auditor be specifically required to reperform a certain level of work (for example, reperform tests of all significant accounts or reperform every test performed by others that the auditor intends to use)?

    Response: Allowing flexibility in determining the extent of reperformance of the work of others seems appropriate. The amount and nature of work reperformed by the external auditor should vary considering such items as the nature of the control, the number of transactions, the risk associated with the account and the quality of the documentation.

16. Is the requirement for the auditor to obtain the principle 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?

    Response: Yes, if the term "principle evidence" is interpreted to mean that the external auditor may rely on the work of management and others after they have obtained adequate comfort that their work is sufficient and may be relied upon. If the term "principle evidence" means that the external auditor must reperform a majority of the sample of tests of controls performed by management and others, the response to this question would be no. Further clarification should be provided as to the meaning of "principle evidence."

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?

    Response: No. The Proposed Standard utilizes vague and open ended phrases such as "more than a remote likelihood" and "inconsequential in amount" and "by itself or in combination." These phrases could be subject to numerous interpretations depending on the reader. Additionally, the Proposed Standard mentions that a misstatement could be less than material (i.e., immaterial) but may still be highlighted because it is more than inconsequential. As currently written, many of these terms are confusing and should be rewritten to be more meaningful, definitive and straightforward.

18. Do the examples in Appendix D of how to apply these definitions in various scenarios provide helpful guidance? Are there other specific examples that commenters could suggest that would provide further interpretive help?

    Response: The examples in Appendix D provide helpful guidance but the examples do not provide a numerical quantification of materiality. Materiality is defined but not quantified in each example and the examples are constructed so that each situation clearly falls into one category or another. The examples do not address the quantitative determination of materiality for a particular transaction or balance. It would be helpful for the Board to provide guidance regarding quantitative materiality.

19. Is it necessary for the auditor to evaluate the severity of all identified internal control deficiencies?

    Response: It is necessary for the external auditor to evaluate the severity of all identified control deficiencies so to determine if it is a significant deficiency, a material weakness or just a deficiency.

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?

    Response: No. Only material weaknesses and significant deficiencies should be communicated to management in writing. All other deficiencies or recommendations for improvements in internal controls should be allowed to be communicated to management either verbally or in writing.

21. Are the matters that the Board has classified as strong indicators that a material weakness in internal control exists appropriately classified as such?

    Response: No. The first two and last two bullets in paragraph 126 of the Proposed Standard could be strong indicators of material control weakness.

However, a weak audit committee, internal audit function, or regulatory compliance function does not necessarily indicate that a material weakness in internal control exists. It is possible that certain companies may have strong internal controls over financial reporting in spite of a weak audit committee, internal audit function, or regulatory compliance function.

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?

    Response: No. The Proposed Standard requires external auditor evaluation of the effectiveness of the audit committee that is too subjective and could create a conflict of interest. The majority of the recommended evaluation factors concerning the audit committee can only be performed through inquiry. How can an external auditor attest to: (i) the independence of the audit committee members from management, (ii) what the audit committee understands about its responsibilities, or (iii) the level of the audit committee's interaction with internal audit, unless the external auditor physically spent significant time with each audit committee member during the year?

    External auditors were just recently criticized in the not too distant past for their relationships with company management who previously approved the auditor's fees. Many individuals viewed this practice as an inherent conflict of interest. Under the current rules issued by the SEC, audit committees are now responsible for approving the auditors as well as their engagement fees. Requiring auditors to separately evaluate the effectiveness of the audit committee could reintroduce the same conflict of interest scenario that the current SEC rules were meant to eliminate.

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

    Response: No. Please see the response to question number 22.

24. If the auditor concludes that ineffective audit committee oversight is a material weakness, rather than require the auditor to issue an adverse opinion with regard to the effectiveness of the internal control over financial reporting, should the standard require the auditor to withdraw from the audit engagement?

    Response: No. Audit committee effectiveness is a very subjective area, and any guidance or requirements issued in this area should be reconsidered. Please see the response to question number 22. Additionally, even if an external auditor was able to attest that the audit committee oversight was ineffective, this should have no bearing as to the effectiveness of the internal controls over financial reporting as the audit committee has no involvement

in the daily financial reporting of the company and the design and monitoring of internal controls over financial reporting.

25. Is it appropriate that the existence of a material weakness would require the auditor to express an adverse conclusion about the effectiveness of the company's internal control over financial reporting, consistent with the required reporting model for management?

    Response: Yes, only if the material weakness in such control could impact the financial statements and no other compensating controls are present over such process. It would also be helpful to discuss in the Proposed Standard the extent to which companies can correct controls that have been identified as significant deficiencies in order to prevent an adverse opinion.

26. Are there circumstances where a qualified "except for" conclusion would be appropriate?

    Response: Yes. For example a small entity or department in a company may have a material weakness as it relates to the segregation of duties of a certain control aspect, but the cost of additional employees may not offset the potential financial statement impact of an error occurring as a result of the lack of segregation of duties.

27. Do you agree with the position that when the auditor issues a nonstandard opinion, such as an adverse opinion, that the auditor's opinion should speak directly to the effectiveness of the internal control over financial reporting rather than to whether management's assessment is fairly stated?

    Response: Yes. This reporting would be the most informative and least confusing.

28. Should the Board provide specific guidance on independence and internal control-related non-audit services in the context of this proposed standard?

    Response: Yes. It would be helpful to know what activities the Board believes could or could not be performed by external auditors. Without specific guidance the companies' primary external auditors may be hesitant to provide certain services to companies or may provide services that they should not be providing.

29. Are there any specific internal control-related non-audit services the auditor should be prohibited from providing to an audit client?

    Response: Should external auditors be allowed to help in documenting client's internal controls or can the external auditors provide guidance on the internal control assessment process that management utilizes?

30. Are the auditor's differing levels of responsibility as they relate to management's quarterly certifications versus the annual (fourth quarter) certification, appropriate?

Response: No. Section 404 of the Act states that "The Commission shall prescribe rules requiring each *annual* report…to contain an internal control report…" Based on this it appears that the intent of the Act was to cover the annual management assessment of internal controls by external auditors and to not require the external auditors to perform limited procedures on management's quarterly reports over internal controls over financial reporting as recommended by the Proposed Standard.

Additionally, there could be instances during the year in which the company may install a new application and once it is operating with actual data and transactions, a material weakness (a programming "bug") could be identified by management that was not identified in the initial design of the application. If management corrects such "bugs" before the end of the year, the auditor should only be required to attest to the effectiveness of the current control, or the control present as of year-end. If the control is effective, management is allowed to conclude that internal controls over financial reporting are effective as of the end of a Company's fiscal year end.

31. Is the scope of the auditor's responsibility for quarterly disclosures about the internal control over financial reporting appropriate?

Response: Please see the response to question number 30.

Sincerely,

Jon A. Graf
Vice President and Controller
Southern Union Company