21 November 2003

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street NW
Washington DC 20006-2083
USA

Dear Sirs

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

The Institute of Chartered Accountants in England & Wales is pleased to provide a letter of comment in response to the PCAOB's proposed standard entitled "An Audit of Internal Control over Financial Reporting Performed in Conjunction with an Audit of Financial Statements".

The Institute is the largest individual body of professionally qualified accountants in Europe with over 125,000 members. Individual members work in many sectors in business, the public sector as well as practising accountants and auditors. We operate under a Royal Charter that reflects our commitment to the public interest.

The proposed standard will have a significant impact on the work not only of US-based auditors and registrants, but also on the UK profession and those individuals throughout the world serving:

- foreign private issuers listed in the US; and
- foreign subsidiaries of US domestic SEC registrants which are bound by the same requirements as the US domestic entity as well as joint ventures with SEC registrant companies.

Consequently, we are sending a copy of this letter to the UK Auditing Practices Board and the International Auditing and Assurances Standards Board.

Introductory remarks

We are aware of the challenges faced by the PCAOB in preparing this exposure draft. Internal control is not a straightforward concept and the measurement of its effectiveness is not easy. Balancing the requirements of the Sarbanes-Oxley Act and the needs and views of investors, regulators, auditors and cost benefit considerations for businesses requires very careful consideration. Upon the Board's decisions on the future of the proposed standard appears to hang issues of expectations, the costs of implementation and future interpretation in the US courts. The pervasive impact of the proposed standard on global audit practice and, potentially, on the platforms used by global audit firms for their audit methodologies, imposes additional significant responsibilities on the PCAOB in finalising the proposed standard.

We are also aware of the debate in the US as to whether or not the Board's proposed standard extends the boundaries of Section 404(b) of the Sarbanes-Oxley Act from 'attestation' to 'audit'. Not all 'attestations' are 'audits'. Whatever the technical arguments for or against this proposed extension, it is a fundamental issue upon which there is a need for clarity from all those involved. We strongly urge the Board to be certain that the many outcomes that are likely to result from the proposed standard, including the costs and benefits to both investors and companies, as well as the liability to external auditors, the level of regulation, the consequent impact on external auditor judgement and the extensive additional work that is required for all SEC registrants, is what was intended by Congress when it passed the Sarbanes-Oxley Act and is also their current view (taking into account the other requirements and sanctions in the Act).

Finally, we hope that the PCAOB will give due consideration to the impact of its proposals on the IAASB's global audit standards and recognise the significance of those standards in discharging its responsibilities.

Key Comments

In addition to our introductory remarks, this letter contains key comments on adverse audit opinions, external auditor reliance on the work of management and others, reporting of control weaknesses and audit committee evaluations. Other general comments are also provided on significant issues. Our answers to the PCAOB's thirty one questions are included in the Appendix to this letter.

1 Adverse audit opinions and definitions

The proposed standard indicates that (under defined circumstances) a material weakness automatically gives rise to an adverse opinion. The proposed standard gives no apparent scope for an 'except for' opinion. Automatic adverse, rather than qualified, audit opinions leave external auditors with nothing left in their armoury as a last resort for situations in which things have gone very seriously wrong in many respects. An adverse opinion is almost universally understood by standard setters to mean that a pervasive, fundamental problem has arisen. Suggesting that such an opinion should be issued where this is not the case is likely to spread confusion.

The proposed definition of a material weakness in paragraph 9 states that a "…material weakness is a significant deficiency that…..results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be detected".

The phrase 'more than a remote likelihood' is derived from FAS 5 and is more tightly defined than the corresponding phrase in the existing AT 501 auditing standard, "does not reduce to a relatively low level". The use of the proposed phrase in connection with the definition of significant deficiencies is likely to result in very few material weaknesses being excluded. This will significantly affect the amount of work to be undertaken by both external auditors and management. We suggest that PCAOB considers whether the definition used in AT 501 is in fact preferable.

Overall, the proposed standard gives the impression of trying to achieve, and having an overall expectation of, ‘perfection’. This somewhat over-enthusiastic approach may not be cost-effective, particularly for smaller and medium sized companies. An appropriate balance of cost, benefit and regulation to improve investor protection is necessary but businesses should not be subjected to unnecessary, costly and stifling bureaucracy. We fear that the combined effect of these proposals would be to:

- inflate the scope of work that external auditors (and presumably, management) will be obliged to carry out;
- lead to scope changes to Section 404 readiness projects already underway at companies; and
- inflate the number of adverse opinions, thereby devaluing their impact which will not enhance investor confidence.

We therefore believe that a material weakness should *not automatically* result in an adverse opinion, and that external auditors should be allowed to use their professional judgement to determine whether a material weakness merits a qualified rather than an adverse opinion. Guidance might be provided on situations in which an adverse, rather than a qualified opinion would be appropriate. Such guidance might be aligned with the IAASB’s standards and guidance on auditors’ reports.

The specific requirements of section 404 (as interpreted by the SEC rules) relate to internal controls over financial reporting. The proposed standard sometimes refers to ‘internal control’ and sometimes to ‘internal control over financial reporting’. The latter is a much narrower term than the former. It is not always clear as to whether references to internal control in the text should be read as references to internal control over financial reporting. We suggest that the matter should be clarified at the beginning of the standard.

In example A-5 the auditor issues an unqualified opinion that refers to the report of the other auditors. We do not understand why a direct report on internal control effectiveness is given here rather than a report on management’s assessment, as with other unqualified opinions.

2 Reliance on internal audit and management testing

The proposed standard appears to restrict unnecessarily the use of judgement by external auditors when deciding whether, and to what extent, to rely on the work of others.

The wording in the proposed standard also appears contradictory. Wording in the introduction to the document seems encouraging about less work being required for companies that have good controls, but paragraphs in the main text of the proposed standard seem to negate this. For example, the second paragraph on page 8 of the introduction states that the work that management performs in connection with its assessment can have a “…significant effect on the nature, timing, and extent of the work the independent auditor will need to perform”. It goes on to state that the proposed auditing standard would allow the auditor to use, to a reasonable degree, the work performed by others, including management and that the more extensive and reliable management's assessment is, the less extensive and costly the auditor's work will need to be. Contrast this with paragraphs 104 and 105 of the proposed standard which detail areas where the external auditors should not, or are limited in their ability to, place reliance on the work of others. Paragraph 109 goes on to state that the external auditor must perform enough of the testing himself/herself such that that the external auditors’ own work forms the “principal evidence”.

Paragraphs 104 and 105 are unnecessarily restrictive. We believe that external auditors should be able use their judgement as to when they can rely upon the work of internal audit, provided that they are satisfied that the internal audit department's work is objective and performed by competent people who adhere to relevant professional standards.

We believe that the proposed standard builds in wasteful inefficiencies by insisting that the external auditor re-performs a substantial amount of testing. Management might reasonably ask (inhibited only by the fear of a qualified or adverse report) why internal audit or management should bother to perform tests if the external auditors are specifically required by the standard to do them again.

In practice, it is a possibility that CEOs will now ask for substantial help from their internal audit functions in complying with the requirements of the proposed standard; either by reviewing the processes and output of the testing on internal financial controls undertaken by management, or even by undertaking much of the detailed testing work on behalf of management. These scenarios, particularly the latter, may not be a welcome development where the remit of internal audit is directed to the provision of assurance to the audit committee and the board on the wider aspects of all an organisation's controls rather than just internal control over financial reporting.

Paragraph 108 of the proposed standard states that internal auditors "…would normally be expected to have greater competence with regard to internal control over financial reporting and objectivity than other company personnel". Whilst internal auditors would normally be expected to have greater *objectivity* than others in this and other areas, they may not have greater competence in financial reporting than financial reporting specialists.

3 Reporting of control weaknesses

We suggest that the requirement for the external auditor to communicate *all* deficiencies to the audit committee will lead to information overload for audit committees. It is likely that audit committees will receive the same or similar lists of issues from both internal and external auditors in the light of the fact that external auditors will have reviewed internal audit reports and must therefore re-communicate all the deficiencies already reported by internal auditors.

Paragraph 126 of the proposed standard states that a significant deficiency that remains uncorrected after some reasonable period of time is a strong indicator of a material weakness. This judgement as to what is 'reasonable' could be problematic, for example where the costs of a suggested control solution outweigh the benefits. Recognition should also be given to situations in which a company has several significant deficiencies but in completely unrelated areas. Does the aggregation principle apply in this case? If so, adverse audit opinions may become commonplace and will their significance be debased in the eyes of investors.

Furthermore, where errors are found, testing would usually be extended to determine whether this is a one-off insignificant error or evidence of a systematic breakdown in a control. Is the standard intended to be read such that one-off errors should be reported even when the auditor was prepared to stand by the judgement that they were not significant?

4 Audit committee evaluation

Paragraph 57 of the proposed standard requires the external auditors to form a view on the effectiveness of the audit committee.

These requirements introduce some circularity in that the audit committee which appoints, removes, approves the remuneration of, and evaluates the external auditor will itself be evaluated by the external auditor. This requirement may place the external auditor in conflict with the audit committee.

Whilst we believe that an assessment of the audit committee is appropriate because the audit committee is an important part of the internal control framework, there is no need for a separate stand-alone requirement. We believe that assessment of the audit committee by the external auditor will be effective provided that safeguards are implemented. These safeguards might involve a requirement for particular attention to be paid to the assessment by a partner or other senior person within the audit firm who is not directly involved with the audit (such as the independent review partner).

We disagree with paragraph 59 which requires that where the external audit evaluates the audit committee as being ineffective, this "…should be regarded as at least a significant deficiency and a strong indicator that a material weakness in internal control over financial reporting exists". A material weakness would automatically lead to an adverse audit opinion. We believe that the external auditor should be allowed to exercise professional judgement and consider other relevant factors, such as the role played by the board of directors. Furthermore, we also believe that reference to the use of judgement should also be made in paragraph 126 which describes other situations which should be regarded as at least a significant deficiency and a strong indicator that a material weakness exits.

In the UK, following the revised Combined Code on Corporate Governance issued in July 2003, from now on boards of directors will have to conduct a performance evaluation of the audit committee (Code provision A.6.1).

Other General Comments

5 Level of controls testing

Appendix B provides four examples of control testing procedures. All are low-level examples that relate to only one of the five COSO components, the 'control activities'. Whilst important, 'control activities' are not the principle areas of concern in cases of fraudulent manipulation of financial reporting.

It was frequently senior management's manipulation of earnings that was a major issue in recent scandals. Issues related to senior management and their ethics are part of the control environment and if examples are to be given at all, then some examples relating to the control environment would be particularly helpful. This is especially the case in the light of paragraph 104 which prohibits reliance by external auditors on the testing of internal audit or management.

The four examples illustrate that a very substantial amount of audit work is expected of external auditors at this basic level. The issuer is already required to carry out its own testing in this regard and those tests should yield the same results as external audit testing. We are not convinced that the requirement to test so much at this low level is necessary to protect investors.

Whilst we would expect basic low level controls to form an important element of the overall comfort obtained by CEOs and CFOs when making their certification, we would expect that they would represent a relatively low proportion. For example, high-level detective controls are typically a very significant element of overall comfort but they are not addressed in the examples.

6 Controls which do not naturally give rise to documentary evidence

Many companies are likely to have effectively designed controls, but it is not always easy to demonstrate or document their operational effectiveness.

For example, day to day supervision, coaching and reviewing of staff and their work in the accounting department are sound preventative controls but are ordinarily not documented on a continuing basis. Despite this, external auditors can often, by a process of enquiry and proper evidential corroboration, gain reasonable assurance that such controls exist and work effectively.

The proposed standard indirectly plays down the importance of such controls and may encourage companies to prepare documentation that would not otherwise be necessary from a business point of view.

We envisage that even routine meetings of management that act as a form of control, such as credit control meetings, will now have to be documented in detail to satisfy the perceived requirements of the standard. This will add additional cost and bureaucracy. The operation of some IT controls may also not be easy to document to the level that may be perceived as necessary under the proposed standard.

We question whether all this additional work on documentation will provide an increased level of protection for investors commensurate with the increased cost of compliance. We also question whether the proposals go further than the intentions of the Sarbanes-Oxley Act.

7 Reasonable assurance is not high assurance

Paragraph 16 states that reasonable assurance is a high level of assurance and that it includes the understanding that there is a relatively low risk that material misstatements will not be prevented or detected. This is a misleading over-simplification of current thinking on this subject that will encourage investors to take much greater comfort from the work performed by external auditors than is warranted.

It is generally accepted that reasonable assurance represents a range of different levels of assurance, depending in part on the qualities inherent in the subject matter. Paragraph 15 of ISA 200 *Objectives and general principles governing an audit of financial statements* issued by IAASB in November 2003 states that reasonable assurance is obtained when the auditor has reduced risk to an acceptably low level. We respectfully suggest that PCAOB aligns its description of reasonable assurance with current thinking in order to prevent false expectations, confusion and misunderstanding in an important area.

8 Need to reflect IT reality and service organisation auditor guidance

Major parts of many internal control systems are IT driven and have been developed either in-house, by a third party, or by a service provider. The guidance in the proposed standard often does not take this reality into account and instead provides guidance which is geared toward manual internal control systems. The proposed standard should acknowledge this reality and provide additional guidance reflecting it.

International and European guidance on the use by external auditors of service provider auditors is very limited and guidance for the service auditors themselves is non-existent. This will undoubtedly result in situations where external auditors will not be able to obtain sufficient comfort for their attestation on management's assessment because the use of the extensive US guidance on this issue cannot be forced on non US service providers and their auditors.

9 Management and auditor imbalances

The PCAOB should not lose sight of the fact that the proposed standard is a standard for external auditors, compliance with which cannot necessarily be forced upon the management of a company. The proposed standard introduces examples of new and specific requirements for companies that exceed those described in the relevant SEC rules on matters including the documentation and testing of controls by management.

Whilst the external auditor may qualify his report on internal controls or issue an adverse opinion if management fails to prepare documentation or test controls to the required standard, the external auditor effectively becomes an agent to prompt management action. Taking a worst case view, the external auditor could be held liable for failure to enforce the requirements of the proposed standards which relate to management, with no corresponding liability for management itself.

It may be appropriate for the SEC to consider the specific responsibilities of issuers in this regard.

10 Conflict over who finds adjustments

The proposed standard requires the auditor to issue an adverse opinion regarding the effectiveness of internal control over financial reporting in case of one or more material weaknesses.

Circumstances presumed to be at least a significant deficiency and a 'strong indicator' of a material weakness include identification by the external auditor of a material misstatement in the year-end financial statements that was not identified by the company's internal controls, even if management subsequently corrects the misstatement prior to issuance of the financial statements.

This change will have a profound effect on the relationship between an entity's management and its external auditors. It does not foster co-operation between management and the external auditor and will increase resistance to adjustments proposed by external auditors. Where the need for an adjustment is agreed there will be a strong incentive for management to claim that they 'found it first' or would have done if they had delayed providing information to auditors until they had completed their own checks. In extreme circumstances, it even may make it difficult for external auditors to perform their work because management may try to keep them out until the preparation of the financial statements is at an advanced stage, thus ensuring that the auditor is not the first to identify adjustments.

11 Assertions too prominent

Several references to financial statement assertions are too prominent and misconceived (penultimate paragraph page 4, paragraphs 66 to 70, Appendix A Example A-1 first paragraph). An audit of internal control over financial reporting should not be based on a 'bottom-up' approach starting with financial statement assertions, but should rather commence by determining the risks of material misstatement, followed by considering controls, and finally considering the financial statements of the entity. Financial statements are designed to report on the status and progress of the business of an entity and are not an end in themselves.

The prominence given to financial statement assertions in the proposed standard is not in line with IAASB standards and guidance on risk assertions. Large and medium size audit firms in Europe are committed to follow IAASB standards as of 2005. This inconsistency would have significant consequences for the move towards global standards. It would also have a profound effect on the audit methodologies to be developed by audit firms. These will become hugely complex and require considerable investment to redevelop software and retrain staff. Therefore, we urge the PCAOB to reconsider the prominence given to financial statement assertions in the proposed standard.

The guidance related to financial statement assertions in the paragraphs indicated above is also inconsistent with the guidance provided in the first paragraph on page 12 which commences with the design and operating effectiveness of controls.

12 Two audits

IAASB standards and guidance on risk require external auditors to identify significant risks to determine which internal controls should be audited further. This is not reflected in the Board's proposed standard which requires auditors to perform audit work on *all* internal controls, regardless of their risk profile.

The guidance in paragraphs 133 to 144 is meant to integrate the two audits (attestation on management's assessment and the audit of financial statements). The level of integration should be deepened such that the two audits serve the same purpose. The objective of an audit of internal controls over financial reporting should be to form a judgement on the control risks; this is part of the financial statement audit. The concepts of materiality and complexity should be introduced whereby internal controls should only be tested for material and complex control assertions, transactions, account balances and disclosures; substantive procedures may suffice for other transactions and balances. The proposed standard currently appears to require both tests of controls and substantive procedures for all assertions, accounts and disclosures.

13 The external auditor's responsibility with respect to fraud

The proposed standard is unclear as to the precise level of responsibility the external auditor assumes in connection with the prevention and detection of fraud.

The auditor is required in paragraph 24 to evaluate *all* controls specifically intended to address the risks of fraud that are reasonably likely to have a material effect on the company's financial statements, which presumably means controls falling under all five COSO components. Does this mean that external auditors are required to confirm that fraud controls are designed to prevent 'more than a remote likelihood of a financial reporting misstatement' arising from fraud and that these controls have operated effectively?

Collusion by more than one member of management to overcome existing controls and thereby perpetrate fraud is often more than a remote likelihood. But collusion is an inherent limitation in any control system and it is very difficult (and expensive) at best for management to implement controls to prevent it; careful consideration by management of the cost-effectiveness of a control must take place before implementation. Similarly, external auditors considering making control recommendations must also take account of cost-benefit considerations.

We fear that failure by external auditors to detect a control weakness in either design or operation which subsequently facilitates a fraudulent act at the issuer may, under the proposals, substantially alter the risk profile of the audit profession.

These requirements are potentially wide in scope and have substantial implications for the amount of work to be undertaken and the associated costs.

If you require any further information, please do contact me.

Yours faithfully

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APPENDIX

Response to the questions in the PCAOB's Request for Comments

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?

No. Firstly, it is not appropriate because it is inconsistent with the practice of the IAASB which uses the term 'audit' to refer to the audit of financial statements only. The auditor's attestation of management's assessment is an assurance engagement leading to reasonable assurance and not an audit. Second, whilst we understand that the US accounting profession understands the word 'attestation' to cover audit, attest and other engagements, not all 'attestations' are audits. Is an audit of internal control what Congress intended when it used the words 'attestation and report' in section 404(b) of the Act?

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?

Qualified yes. Whilst we do not like restrictive prohibitions, we understand that legislation requires the two audits should be done together.

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?

In view of the answer to question 2, no.

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?

Qualified yes. Whilst we recognise that the PCAOB is sensitive to the needs of the many small and medium sized issuers, time will tell if the consideration was 'appropriate'. We are particularly concerned about the additional burdens on the small and medium sized registrants and hope that Appendix E will assist them and that its thinking will be incorporated into the proposed standard.

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.

No. Auditing standards should not specify levels of competence and training for audit specified procedures. These matters are already found in the national and international guidance on ethics.

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?

Qualified yes. We believe that the standard's proposed requirements for the performance of procedures to obtain evidence directly are at the same time excessive and unnecessarily restrictive, particularly insofar as auditors are not permitted to use their judgement in determining the extent to which they may use the results of testing by management and others (paragraphs 104 and 105).

We are not convinced that the requirement to obtain direct evidence of effectiveness in all areas of internal controls over financial reporting represents a reasonable use of resources from the point of view of investors, particularly in respect of the testing of control activities. The issuer is already required to carry out its own testing in this regard and those tests should yield the same results as external audit testing.

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

No. Although the suggestions included in paragraphs 43 to 47 on documentation might be helpful, the auditor should be allowed to apply professional judgement. We suggest that additional guidance is included on documentation requirements in line with the size of the entity.

Paragraph 43 refers indirectly to the COSO framework. Where a company is using a different framework for evaluation internal controls, the documentation may use different but equivalent components. Paragraph 43 should be amended to make this clear.

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

(a) Yes, as it allows for the use of professional judgement by the auditor.
(b) No.

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

Qualified yes. Walkthroughs are useful to document an understanding of processes and systems, but are not a comprehensive way of testing the effectiveness of controls. Materiality should be used by the external auditor in his judgement when deciding which systems and processes should be subject to walkthroughs.

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?

No. The external auditors using their professional judgement should be allowed to rely on walkthroughs performed by internal auditors and others after evaluating the objectivity and competence of the internal audit function. We refer to key comment 2 in our covering letter.

11. (a) 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 (b) every year or (c) may the auditor use some of the audit evidence obtained in previous years to support his or her current opinion on management's assessment?

(a) No.
(b) No.
(c) Yes.

The basic principle that external auditors should be able to use their prior knowledge and experience is applicable to every audit and should also be adopted for this type of engagement. Use of such knowledge is of course subject to the proviso that external auditors only rely on past experience after having satisfactorily updated their knowledge of the business in order to identify and focus on changes. This approach is reflected in IAASB's recently revised standards and guidance on risk assessment and internal controls

A requirement to obtain evidence on the effectiveness of controls for every control assertion, for every account balance and disclosure every year is impractical for the auditor and represents a disproportionate use of resources from the point of view of investors. External auditors who undertake high quality audit work should be permitted to use their professional judgement.

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

External auditors should never be required to *use* the work of management and others, but should be permitted to do so using their good professional judgement where appropriate. External auditors should only be able to *rely* on the work of others once they have satisfied themselves that it appropriate so to do.

The extent to which external auditors should be permitted to do so is further detailed in the response to question 13 below. We refer to key comment 2 in our covering letter.

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

No. We refer to key comment 2 in our covering letter.

We are sceptical about the practical application of such a rule-based approach to categorisation of controls, as described in paragraphs 104 and 105. We prefer a more principle-based approach whereby a range of controls from high level, management driven controls to low level routine controls is used to determine the acceptable level of reliance for the auditor. Control categorisation is not required because the important determining factors are the integrity and good faith of management, internal audit and others upon whom the external auditors may rely.

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

Qualified yes. The guidance provided in paragraph 108 is acceptable if the categorisation as described in question 13 is abolished and external auditors are be able to rely on internal audit work in the areas described in paragraph 104, when they consider it appropriate.

15. (a) Is the flexibility in determining the extent of reperformance of the work of others appropriate, or (b) 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)?

(a) Yes.
(b) No.

External auditors should use their professional judgement to determine whether it is appropriate to rely on the work of others.

We refer to key comment 2 in our covering letter.

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?

No. External auditors should use their professional judgement to decide on which sources of evidence to rely, to determine whether it is appropriate to rely on the work of others, and to determine whether there is a need to obtain the principal evidence through their own work.

We refer to key comment 2 in our covering letter.

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?

No. We refer to key comment 1 in our covering letter for our views.

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

(a) Yes.
(b) No.

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

Yes.

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?

Qualified no. We refer to key comment 3 in our covering letter, particularly in respect of reporting to the audit committee.

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

Qualified yes. The issues identified are appropriate but external auditors should be permitted to use their judgement in this area.

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?

Qualified yes. The assessment should not be a separate requirement. We refer to key comment 4 in our covering letter.

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

Qualified yes. We refer to key comment 4 in our covering letter.

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?

No. We consider that requiring an auditor to resign is not something that should be encouraged in anything other than extreme circumstances. Such a general requirement is unlikely to help investor confidence. External auditors should be allowed to use their professional judgement, depending on the circumstances of the situation.

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?

No. We refer to key comment 1 in our covering letter.

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

Yes. We refer to key comment 1 in our covering letter.

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

No.

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

No. Other existing standards address such issues at length. We refer to our response to question 29.

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

Yes. Although we favour principle-based standards which rarely include prohibitions, we believe that it is appropriate to limit the performance of certain internal control-related non-audit services by the financial statement auditor. No additional guidance is required in this respect as the SEC independence rules deal with this topic in sufficient detail.

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

Yes. However we note that section 302 of the Sarbanes-Oxley Act and the related SEC rules do not require quarterly reporting for foreign registrants.

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

See answer to question 30.