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**Rajeev Bhalla**  
Vice President and Controller

November 21, 2003

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

Sent via email to [comments@pcaobus.org](mailto:comments@pcaobus.org)

Re: 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

Lockheed Martin Corporation welcomes the opportunity to provide comments on this proposed auditing standard, PCAOB Release No. 2003-017. Lockheed Martin is a publicly traded corporation principally engaged in the research, design, development, manufacture and integration of advanced technology systems, products and services. In 2002, we reported sales of \$26.6 billion.

Before responding to the specific questions posed in the draft, we have some general comments.

We recognize and commend the Board for striving to balance the needs of its various constituencies in addressing this complex audit issue. We are concerned, however, that some provisions of the draft will still result in costs to companies well in excess of benefits to be achieved, both by the companies as well as the investor community. Specifically, the requirements for certain levels of external audit activity regardless of the quality and amount of management and internal audit effort—or for that matter the business, control, and ethical environments the company operates in—are troublesome. We feel this will result in excessive and duplicate testing—and cost—without corresponding benefit. In this instance, we believe the requirements confuse “audit activity” with “accomplishment of audit objectives.” Provision for auditor discretion should be made in this area.

Here are our comments concerning some of the specific questions raised in the draft:

Question 1—Attestation or Audit

We believe these terms are not interchangeable. We believe the language and intent of the Sarbanes-Oxley Act call for an attestation, not an audit. This proposed standard prescribes an audit.

Question 6—Scope of the Audit

We believe the scope of audit testing, and the amount of direct evidence to be gathered, should be determined by the auditor's judgment, taking into account the risks posed by the company's specific business and control environment, and the factors that can mitigate those risks. Intuitively, the controls of a company with a culture and demonstrable practice of integrity and "doing the right thing" should require less testing than the controls of a company with an aggressive, "push the envelope" culture and method of operation. The goal should be the achievement of audit (or attestation) objectives in an efficient manner.

Question 8—Inadequate Documentation

We do not believe inadequate documentation, regardless of context or effect, should be considered an internal control deficiency per se. Documentation may be a control, but it may also be merely one form of evidence of a control; there may be alternative evidence available. In the latter case, we do not see how inadequate or absent documentation could be construed to be an internal control deficiency.

Question 9—Walkthroughs

While we believe that walkthroughs have their place in the auditor's toolkit, we do not believe walkthroughs are practical or necessary in all cases. The auditor should be allowed to use judgment to determine the best method of achieving the audit objective.

Question 10—Requirement that only Auditor Performs Walkthroughs

As stated in our response to question 9 above, we believe there are instances where a walkthrough performed by the external auditor is not only unnecessary, but impractical. The auditor should be allowed to exercise judgment as to whether walkthroughs are required in all cases and, if required, whether a surrogate such as internal audit may be relied upon to perform the work.

Question 11—Annual Testing of All Relevant Systems versus Reliance on Prior Period Audit Work

We believe there are instances—for example, mature processes (no recent changes) involving minimal exercise of judgment performed by long-time employees who have proven to be competent and adequately trained—where the low level of risk could appropriately lead to reduced or periodic audit effort. We believe the audit standard should acknowledge this very real

circumstance, and allow the auditor to exercise his or her judgment in this regard. If necessary, additional guidance could be developed to aid the auditor in making this judgment.

*Question 12—Use of the Work of Management and Others*

Depending on the degree of independence afforded the internal audit function by its charter, reporting relationship to management, and relationship with the Audit Committee of the Board of Directors, we believe the use of work performed by the internal audit function should not only be permitted but encouraged. In many cases, we do not see a meaningful difference in independence between an internal audit organization that reports to the Audit Committee, and an external auditor that is hired by and reports to the Audit Committee.

Among other things, we are concerned that demands made for work to be performed exclusively by the external auditors could potentially outstrip the capacity of the audit firms. This could lead to delays in performing the work, and likely would (given the law of supply and demand) result in significantly higher fees charged to companies and their shareholders. In our view, the ability of the external auditors to use the work of internal auditors and management, where appropriate, provides necessary elasticity to the supply of competent and experienced internal control testers and evaluators.

*Question 13—Categories of Controls Defined*

We agree with the categories of controls as defined, but disagree with the characterization of general IT controls in the draft. We do not understand, nor support, the position that work on the evaluation of general IT controls must be the exclusive realm of the external auditor.

*Question 14—Role of Internal Audit*

In our view, the draft does not sufficiently recognize and value the role of the internal auditor, nor does it acknowledge the distinction between internal audit and management. As mentioned above in our remarks under question 12, we believe there are more similarities between some internal audit organizations and the external auditor in terms of mission, training, and governance, than there are between those same internal audit organizations and management. The final standard should reflect this reality and expand the scope for acceptability of the work of those internal audit organizations, if necessary providing criteria by which the independence of the internal audit organization could be evaluated.

*Question 15—Auditor Flexibility in Using the Work of Others*

The auditor should be permitted to exercise his or her professional judgment in this area.

Question 17—Definitions of Significant Deficiencies and Material Weaknesses

We believe the definitions need further development and clarity, and need to be reconciled with each other and with the rest of the standard to eliminate inconsistencies and improve coherence. The mixture of established and well-understood terms of art, such as remote and material, with newer and less-well-defined terms, such as inconsequential, is particularly confusing.

We also believe that “inconsequential” (as we understand the use of the term) establishes a much lower threshold than appropriate for the purposes of this standard. We are concerned that this would result in a high volume of relatively minor issues that would need to be addressed (or at least debated), and that this would distract attention, resources, and focus from the more serious deficiencies.

We further believe that the well-established concept of compensating controls should be further acknowledged, and additional guidance provided on how it can be relied upon, in the final standard.

Question 20—Requirement for Auditor to Communicate All Deficiencies

We think the same principle should apply here as in a financial statement audit, namely that the auditor use his or her judgment to determine which findings are sufficiently significant to communicate to management.

Question 25—Adverse Opinion Due to a Material Weakness

Since management’s representation is as of a point in time (December 31), the auditor’s report should correspond to the same point in time. Therefore, an adverse opinion should only be required if a material weakness remains in effect at (has not been corrected by) the date on which management is reporting.

Question 27—Auditor Speaking Directly to Internal Controls in a Non-standard Opinion

We disagree with the position taken in the draft and the Board’s explanation thereof. We also believe this position undercuts the Board’s assertion that the auditor’s examination of internal controls under this standard is necessary only in the context of evaluating management’s assertion on the subject (see comments under questions 1 and 6 above). If the auditor’s task is to evaluate management’s assertion, let he or she do so. It is inconsistent and inappropriate to change the scope of the auditor’s report based upon the audit conclusions.

If desired, we would be happy to provide more information about our reasoning. Thank you for considering our concerns during the Board’s deliberations.

Sincerely,

/s/ Rajeev Bhalla  
Vice President and Controller