November 21, 2003

Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington, D.C. 20006-2803

RE: PCAOB Rulemaking Docket Matter No. 008

Dear Sir/Madam:

The undersigned wishes to comment on behalf of The Boeing Company (the "Company") on the Proposed Auditing Standard, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements.* The Company supports the issuance of a new standard for auditing internal control; however, we wish to convey certain comments on the proposed standard, as set forth herein. Our comments pertain to the following general topics:

- Auditor professional judgment
- Definitions of "significant deficiency" and "material weakness"
- Audit Committee oversight
- Superseded controls

Auditor professional judgment

Existing auditing standards generally allow for broad application of auditor judgment. Despite certain audit failures that have occurred recently, the audit process overall has functioned effectively. We believe the new standard for audits of internal control over financial reporting should continue to allow the auditor to exercise judgment in designing audit tests and evaluating results. Related to the proposed standard, we have comments on the use of auditor judgment related to certain areas, including walkthroughs, use of the work of others, and evaluation of internal control deficiencies. In each situation indicated below, we believe incorporation of auditor judgment is necessary to produce results that are truly representative of the underlying circumstances.

Walkthroughs

The proposed standard requires the auditor to perform a walkthrough for all significant processes of a company. In question 10, the PCAOB asks whether it is appropriate to require that the walkthroughs be performed by the auditor himself, rather than allowing the auditor to use the walkthrough procedures performed by management, internal audit, or others. While we agree that walkthroughs provide evidence that supports the process flow of transactions, the design of controls and whether controls are in operation, we believe that it is neither practical nor necessary for the auditor to perform a walkthrough for *all* significant processes. The effort involved in complying with this aspect of the proposal, as written, would require a very large time commitment by company personnel and the auditor, and would result in unduly high audit fees. Rather than requiring the auditor to perform a walkthrough of each significant process, we suggest the auditor use professional judgment to determine which of the significant processes require an auditor-performed walkthrough to support the auditor's opinion.

In performing a walkthrough, the proposed standard states that the auditor should include *all types of transactions and events* that flow through a significant process. Because of the varying materiality and significance of different types of transactions, we believe that it is neither practical nor necessary for the auditor to include "all types of transactions and events" in a walkthrough of a process. Rather, we suggest that a walkthrough include a representative sample of transactions and events for the process, selected by the auditor using professional judgment.

Use of the work of others

The proposed standard requires the auditor to perform enough testing first-hand, that the auditor's original work provides the principal evidence for the auditor's opinion, hence subjecting the amount of reperformance of other parties' tests to auditor judgment. In question 15, the PCAOB asks whether the proposed flexibility in determining the extent of reperformance of the work of others is appropriate, or whether the auditor should be specifically required to reperform a certain level of work. We believe the proposed flexibility afforded to auditors is appropriate. Because the quality and extent of work performed by management, internal audit, and others varies depending on many factors, we believe a prescriptive approach would be inappropriate. Professional judgment should be relied upon to tailor the auditor's reperformance efforts based on the competence, objectivity, timing, and extent of the work of others. Likewise, we believe reperformance should not require duplication of each and every test performed by the initial party.

The proposed rule also specifies several areas in which the auditor shall not use the results of testing performed by others, including certain controls that are part of the control environment, controls over period-end financial reporting, information technology general controls, and walkthroughs. In question 12, the PCAOB asks to what extent the auditor should be permitted or required to use the work of others. We believe use of the work of others should be at the auditor's discretion, and should not be explicitly precluded in any circumstance. The auditor should be permitted to exercise professional judgment in determining the extent to which the auditor can incorporate the use of testing by others.

Evaluation of internal control deficiencies

The proposed rule indicates that the auditor must determine whether internal control deficiencies constitute significant deficiencies or material weaknesses. In question 19, the PCAOB asks whether it is necessary for the auditor to evaluate the severity of *all* identified internal control deficiencies. We believe such evaluation is necessary. The auditor should evaluate the significance of a deficiency in internal control by considering the likelihood and potential magnitude of a possible misstatement in the financial statements, using professional judgment.

In question 8, the PCAOB poses a similar question, asking whether inadequate documentation is an internal control deficiency, for which the auditor must assess the severity, or whether it should automatically be deemed a significant deficiency or material weakness. Our response is that inadequate documentation should not be prescriptively evaluated or automatically designated, but subjectively analyzed in the context of the entire internal control structure. In fact, we believe more broadly that none of the controls and circumstances listed in paragraphs 123 and 126 should be automatically designated as significant deficiencies or material weaknesses (or strong indicators thereof). We believe the auditor's professional judgment is required to appropriately analyze the specific circumstances surrounding the internal control deficiency.

Definitions of "significant deficiency" and "material weakness"

The proposed rules include new definitions for control deficiencies, including "significant deficiency" and "material weakness." In question 17, the PCAOB asks whether the new definitions of these terms will provide for increased consistency in the evaluation of deficiencies, and asks how the definitions can be improved. We believe the new definition for a significant deficiency requires further clarification as described below.

Current auditing literature defines the terms significant deficiency and material weakness as follows:

> *Significant deficiency / reportable condition (significant deficiency has same meaning as reportable condition, per the SEC):* a significant deficiency "in the design or operation of internal control that could adversely affect the entity's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements."
>
> *Material weakness:* "a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements may occur and not be detected within a timely period by employees in the normal course of performing their assigned duties."

The proposed rules define the terms significant deficiency and material weakness as follows:

> *Significant deficiency: "*a significant deficiency is an internal control deficiency that adversely affects the company's ability to initiate, record, process, or report financial data reliably in accordance with generally accepted accounting principles. A significant deficiency could be a single deficiency, or a combination of deficiencies, that results in more than a remote likelihood that a misstatement of the annual or interim financial statements that is more than inconsequential in amount will not be prevented or detected."

> *Material weakness:* "a material weakness is a significant deficiency that, by itself, or in combination with other significant deficiencies, results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected."

The proposed new definitions are written more prescriptively and narrowly than the existing definitions. The definition in the proposed standard of "significant deficiency" is comprised of two main components: 1) "more than a remote likelihood" of a misstatement, involving 2) an amount that is "more than inconsequential." We believe the first component referencing "more than a remote likelihood" is well understood by management and auditors, as the term "remote" is specifically indicated to have the same meaning as in SFAS No. 5. The term "remote" is broadly applicable and regularly used in certain other accounting assessments. By referring to the term "remote," we interpret that the PCAOB intends to clarify the previous use of the term "could" that is contained in the existing definition, and we support such clarification.

However, in the second component of the definition, the term "inconsequential" is not well understood. Further, the examples currently included in Appendix D do not elaborate on the meaning of this concept, except to indicate that the scenarios deemed significant deficiencies were not material. We believe the "more than inconsequential" threshold should be defined and explained more fully to reduce diversity in interpretation among management, the auditor, the audit committee, and any other interested parties.

Audit committee oversight

The proposed rule sets forth requirements for the auditor to evaluate the effectiveness of the audit committee as part of the control environment and monitoring components of a company's internal control over financial reporting, and includes specific factors related to audit committee effectiveness that the auditor should evaluate. We agree that the effectiveness of the audit committee is an important aspect of the control environment and monitoring components of a company's internal control over financial reporting. However, we suggest that the list of specific evaluation factors be omitted, and replaced by reliance on the guidance provided in the COSO framework. In describing the control environment, the COSO framework identifies the audit committee as playing an important role in establishing an effective "tone at the top" for an organization. The COSO framework also provides a list of specific matters related to the audit committee that might be considered in an evaluation of the control environment. We believe that the guidance in the COSO framework is sufficient.

Additionally, the proposed rule provides a list of circumstances that are automatically regarded as at least a significant deficiency (and possibly a material weakness). Ineffective oversight by the company's audit committee is included in that list. We believe the auditor's professional judgment is required in all cases to determine the severity of identified internal control deficiencies, and that no deficiencies, including ineffective oversight by the company's audit committee, should be automatically designated as significant deficiencies or material weaknesses (or strong indicators thereof).

Superseded controls

From time to time, companies implement changes to their controls. The proposed rule indicates that when such changes occur, the auditor may need to evaluate controls that have been superseded if the new controls have not been in effect for a sufficient period. Because management's assertion and the auditor's opinion are expressed as of a certain date, we believe the auditor should not be required to evaluate controls that were superseded and replaced before the date being reported on. We believe superseded controls are irrelevant to the reports of management and the auditor, as both are stated as of a particular point in time.

Finally, we wish to express our concern over the high potential costs to companies, and ultimately the investing public, to compensate the auditor for the extensive audit effort required to comply with the proposed regulations. Based on these proposed rules, we expect a sharp increase in audit fees, in addition to higher internal costs required to support management's internal control assessment. While we generally support the overall intent of the proposed auditing standard, we ask the PCAOB to focus on the cost-benefit relationship and impact of decisions made, being mindful of the value that will be gained for investors.

Sincerely,

James A. Bell
Senior Vice President of Finance & Corporate Controller