

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 Number 008

Proposed Auditing Standard – An Audit of Internal Control over Financial Reporting Performed in Conjunction with an Audit of Financial Statements

The Confederation of British Industry (“CBI”) is the principal business association in the United Kingdom representing all sizes of both UK companies and foreign companies with places of business in the UK, and including UK companies who are listed or traded on the US securities markets.

We have been closely following the implications and requirements of Sarbanes – Oxley for UK companies affected, who are anxious to understand the implications of, and observe the requirements of, and understand the implications of, the US legislation and rules made by the SEC and other regulatory bodies which affect them.

Accordingly, the CBI welcomes the opportunity to comment on proposed rules and requirements which will affect UK companies with listings in the US.

Our comments are directed from the standpoint of seeking to ensure proportionate and appropriate rules, which will not result in excessive burdens or costs being placed on UK companies and their audit firms, whilst remaining consistent with the requirements of Sarbanes – Oxley.



Key issues for CBI member companies

1. Adverse audit opinions

We do not believe that a material weakness should automatically result in an adverse opinion. External auditors should use their professional judgement to determine whether a material weakness merits a qualified rather than an adverse opinion. The PCAOB could provide guidance on situations in which an adverse, rather than a qualified, opinion would be appropriate.

The SEC interpreted the requirements of section 404 to relate to internal controls over financial reporting. The proposed standard sometimes refers to ‘internal control’ and sometimes to ‘internal control over financial reporting’. 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.

2. Reporting of control weaknesses

We suggest that the requirement for the external auditor to communicate *all* deficiencies to the audit committee will usually lead to excessive information for audit committees. This requirement should be amended to exclude all the deficiencies already reported by internal auditors, as well as enabling the grouping of similar types of deficiencies.

We do not accept the proposition that a significant deficiency that remains uncorrected after some reasonable period of time is a strong indicator of a material weakness. As an example, could this encompass a judgement that it is ‘reasonable’ not to correct a deficiency where the costs of the control exceed the benefits? A further issue is whether the aggregation principle applies in situations where a company has several deficiencies in unrelated areas. If it does, then adverse audit opinions may become common and their significance will be devalued.

3. Level of controls testing

The examples of control testing procedures 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.

4. Controls which do not naturally give rise to documentary evidence

Effectively designed controls are not always easy to demonstrate or document. 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.

5. Weakness identification

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. This includes the 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 will have a profound effect on the relationship between an entity's management and its external auditors, since it will increase resistance to adjustments proposed by external auditors. Even where the need for an adjustment is agreed, there will be unnecessary arguments as to which party identified the weakness incentive first. It may also 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.

We hope you find these comments helpful.

Yours faithfully

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CBI Company Affairs