Moody's Investors Service

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

Re: Proposed Auditing Standard – Reporting on the Elimination of a Material Weakness
(PCAOB Rulemaking Docket Matter No. 018)

Moody's Investors Service supports the PCAOB's proposed auditing standard on the reporting on the elimination of a material weakness.

As discussed in our recently published Special Comment, *Section 404 Reporting on Internal Control: Our Early Experience*, we believe there are two areas where disclosure about material weaknesses could be improved:

- First, many companies could often be more specific about the nature of material weaknesses they report. Vague generalizations raise more questions than they address. More detail would help users better understand the relative severity of the material weaknesses and would reduce uncertainty about a company's financial reporting.
- Second, companies could be more specific about their plans to remediate material weaknesses and the timing for doing so. Some companies disclose little about their remediation plans.

Looking forward, we expect that many companies will update users in their quarterly filings on their progress toward remediation of material weaknesses. We welcome those updates. We would also welcome an auditor's report on the successful elimination of a material weakness when it occurs, rather than waiting until the next annual reporting cycle.

As discussed in our Special Comment, *Section 404 Reports on Internal Control: Impact on Ratings Will Depend on Nature of Material Weaknesses Reported*, dated October 2004, we consider all material weaknesses in our credit ratings. Under our approach, management's response to a material weakness is critical; we try to assess whether management is taking the problem seriously and that timely correction is underway. Just as we value disclosure about material weaknesses, we also value disclosure about their timely remediation. Similarly, just as we value auditor attestation about material weaknesses, we also would value auditor attestation about their remediation.

We understand that auditors currently evaluate management's quarterly certifications about changes in internal control over financial reporting. On the one hand, the auditor's procedures during interim periods, primarily observation and inquiry, are limited and not sufficient to allow the auditor to attest to remediation. On the other hand, requiring a complete re-assessment of internal control over financial reporting during an interim period would be costly and time consuming.

We believe the proposed standard strikes a useful balance by giving companies the option to provide users with information they value and with the assurance they find useful while not requiring a complete re-assessment.

The following responds to your particular questions:

1. Does the sample auditor's report, which is included in the proposed standard, clearly describe the results of the engagement? If not, how might it communicate more clearly to report users?

   Yes.

2a. If the auditor does not express an opinion on all of the material weaknesses that were identified during the company's most recent audit of internal control over financial reporting, should the proposed standard require the auditor's report to specifically identify the additional material weaknesses?

   Yes. Failure to identify the additional material weaknesses might lead some users to erroneously conclude they no longer exist, or that the auditor overlooked them. Also, reference to these material weaknesses in the auditors' report maintains the linkage between management's disclosures and the auditor's report, which we find useful.

2b. Would such a requirement provide helpful information to report users or would it detract from an otherwise clear communication by implying that the auditor believes that those material weaknesses <u>do</u> still exist or that only those material weaknesses exist (i.e., no other controls have materially deteriorated since the date of the annual assessment of internal control over financial reporting)?

   It would provide helpful information. However, if reported, users would likely conclude that those material weaknesses still exist. This is because if management had remediated those material weaknesses, management would likely have requested the auditor to attest to that remediation too. As a result, we see little chance of corrected material weaknesses being identified in the auditor's report as still existing.

   We doubt that users would incorrectly interpret the auditor's report as providing assurance that no new material weaknesses have arisen since the date of the last annual assessment. Your proposed auditor's report makes clear that the engagement is limited only to reporting on the elimination of a material weakness.

2c. Might specific identification of other material weaknesses not addressed by the auditor's report deter companies from engaging the auditor to perform this work unless the company believed that <u>all</u> previously reported material weaknesses had been eliminated?

Perhaps. However, we believe that auditor's reports should refer to those weaknesses for the reasons described above.

3. Should this standard allow an auditor to report on the elimination of a material weakness in the circumstance in which the material weakness was identified and eliminated by management as of an interim date (in other words, identified and eliminated without ever being addressed in the company's Section 404 reporting)?

Yes. However, in doing so, it is important for the auditor's report to clearly distinguish between (i) material weaknesses identified in the company's last annual assessment (i.e., in the company's Section 404 reporting) and (ii) material weaknesses subsequently identified and eliminated by management. Without clearly distinguishing between the two, some users might erroneously conclude that the auditor has performed a complete re-assessment of the company's internal control over financial reporting.

Moody's appreciates the opportunity to comment. If you should have any questions, please contact me at (212) 553-1449 or Michael Doss at (212) 553-1919.

Sincerely,

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