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

Regarding: PCAOB Rulemaking Docket Matter No. 018

We are pleased to comment on a proposed Auditing Standard, "Reporting on the Elimination of a Material Weakness." Our comments follow the paragraph numbers in the proposal.

1. Paragraph 11. We suggest providing examples of how the "other components" of internal control over financial reporting, such as monitoring and risk assessment, can be expressed in terms of control objectives that relate to "a relevant financial statement assertion". It seems that the connection between the other components relate at best in an indirect fashion to a given financial statement assertion such as completeness for a financial statement line item. To avoid creating audit work that may not be intended, resulting in additional cost for registrants, the Board should provide guidance in the standard on how to express those "other components" in terms of specific control objectives over financial statement assertions.

2. Paragraph 23. Here, and elsewhere, the engagement of a successor to report on elimination of a material weakness is referred to as the "initial engagement". We suggest clarifying this term. The successor auditor may view the "initial engagement" to be the engagement to perform the integrated audit of the financial statements and internal control as well as to review quarterly information. Some reviews of quarterly information may have already been performed. Hence, the engagement of a successor to report on elimination of material weakness may not be the "initial engagement."

3. Paragraph 23c. While it may often be useful for the successor auditor to communicate with the predecessor about the basis for the predecessor's determination that a material weakness existed, we question whether it will be cost-effective to require this in all circumstances. The successor auditor needs to perform sufficient procedures, as specified in paragraph 23 and elsewhere, to obtain knowledge of relevant internal controls, and presumably the predecessor will have read the description of material weakness provided in the predecessor auditor's report. We question the need to perform the procedures that will be required to inquire of the predecessor and obtain an understanding of the predecessor's basis, when presumably the predecessor's report will indicate the material

weakness with suitable specificity as will management's report and documentation as to the elimination of the material weakness, and these latter two sources should be sufficient.

4. Paragraph 37. Under paragraph 185 of Auditing Standard No. 2, a principal auditor may refer to a report of another auditor as a basis for the principal auditor's opinions. Management and the principal auditor would each report on a material weakness, even if the material weakness was present in a subsidiary audited by another auditor. Presumably the subsidiary auditor would have performed audit procedures regarding the material weakness at the subsidiary they audited. We believe it will significantly add to the cost of an engagement regarding elimination of a material weakness if paragraph 37 of the current standard prohibits the principal auditor from referring to a report of another auditor as a basis for the principal auditor's opinion about the elimination of a material weakness. Paragraph 37 should be revised to permit the same division of responsibility as contained in paragraph 185 of Auditing Standard No. 2.

If paragraph 37 is not changed, it will require the principal auditor, in assuming full responsibility, to audit at least part of the entity that was previously audited by another firm. This cannot be efficient or cost-effective.

5. Paragraph 40f. This paragraph requires the auditor, in reporting on the elimination of a material weakness, to obtain a management representation letter that lists all material fraud and all fraud involving management. This does not seem efficient or cost-effective. We suggest that it is not necessary, in the limited focus of the audit of the elimination of a specified material weakness, to obtain representations unrelated to the specific material weakness that is the focus of the engagement.

If paragraph 40f is not changed, the standard should give guidance as to what the auditor is expected to do with a representation that describes a nonmaterial fraud that is not relevant to the specified material weakness. What procedures does the Board think should be done, and documented, regarding these additional representations, and are those procedures worth the cost involved in performing them? If the procedures are perfunctory ("read the representation") then what is the benefit of performing them or the assurance provided by the procedures?

6. Paragraph 47(l). The requirement in paragraph 47(l) to state that "the engagement includes obtaining an understanding of internal control over financial reporting" is very likely to require additional audit work that would not be cost-effective. The limited nature of a report on elimination of a material weakness should not require the auditor, <u>as part of the engagement performed on the elimination of the material weakness,</u> to obtain an understanding of internal control over financial reporting. Such an understanding would have to be performed and documented as part of the current engagement under Auditing Standard No. 3's documentation requirements, to allow an experienced auditor, with no other connection to the audit, to understand what was performed in obtaining the

understanding of the very broad area of "internal control over financial reporting" as part of "the engagement" regarding elimination of a material weakness.

Presumably the auditor obtained such an understanding of internal control over financial reporting in the prior engagement to audit and report on internal control, in which the material weakness was identified and disclosed. However, the wording proposed is that as part of the (current) engagement, the auditor obtained such an understanding, not that the auditor obtained the understanding as part of the prior engagement that was performed. We suggest this wording be removed or that it be changed to refer to an understanding obtained in a prior engagement, so as to not require obtaining the understanding as part of the current engagement. The situation where a new auditor is reporting on the elimination of a material weakness would properly require including the language about obtaining an understanding of internal control over financial reporting since a new auditor would have to obtain this understanding.

The fourth paragraph of the example report under A-1 in Appendix 1 also requires the same change to avoid excessive audit work. The statement in the example auditor's report about obtaining an understanding is not limited to "internal controls over financial reporting relevant to the material weakness". Instead, it states that the auditor obtained "an understanding about internal control over financial reporting" as part of "our engagement" involving elimination of a material weakness. Auditing Standard No. 2 requires 41 paragraphs (paragraphs 47 through 87) to explain what is involved in "obtaining an understanding of internal control over financial reporting" and we submit that it is not cost-effective to those 41 paragraphs of procedures (company-level procedures, major classes, walkthroughs, etc.) to be performed (or to be stated that they were performed) in a limited engagement.

We suggest limiting the understanding required and reported to "an understanding of internal controls relevant to the control objective for which a material weakness was reported."

7. Paragraph 47(o). We believe that the second bullet in paragraph 47(o) refers to an inappropriate date. If not revised, this may lead to require audit work which we do not believe would be cost-effective. The second bullet indicates that the auditor is to state that the auditor has not applied auditing procedures as to the effectiveness of controls "as of any date after <u>the date of</u> management's annual assessment…". If management's assessment of controls "as of" a year-end of December 31, 2005 is completed on and is itself dated February 28, 2006, the proposed wording would thus state that the auditor has not applied auditing procedures as to the effectiveness of controls "as of any date after February 28, 2006", which is the date management finished its assessment of its controls as of December 31, 2005.

This does not agree with the report provided by the auditor under Auditing Standard No. 2, in which there is no reference to the "date of" management's annual assessment but which instead refers to management's assessment of controls "as of" year-end. Under Auditing Standard No 2, the auditor does not indicate they have done any procedures regarding controls through the date of completion of management's assessment of the status of year-end controls. The proposed language is subject to a different inference, that in fact something more may have been done about controls in existence at February 28, 2006, although nothing has been done about controls in existence after that date except for the material weakness that has been eliminated. This potential meaning may lead a reader to erroneously conclude that the auditor previously expressed some assurance about internal controls as of the date of completion of management's assessment, which may lead an auditor to perform some testing of controls as of the date management's annual assessment is completed. In other words, if the auditor says they didn't do anything about control effectiveness after a certain date, shouldn't that infer they did something as of that date and shouldn't users expect something to have been done?

We suggest removing references to "the date of management's annual assessment" and indicating clarifying that the relevant date beyond which "as of" controls were not tested is the year-end date.

8. The "note" appended to paragraph 47(o) may be useful in the auditor's report whether there is a successor auditor or not. The auditor, in auditing the assertion as to the elimination of a material weakness, is not reaching conclusions about the effectiveness of any controls of the company other than the controls specifically identified. This should be stated in the auditor's report, regardless of whether a successor auditor is used or not.

9. Paragraph 50c. The reference to "a significant subsequent event" is too broad a reference and will lead to audit work not necessary to the scope of a limited engagement to report on elimination of a material weakness. Assume a company obtained revised debt financing or settled a lawsuit. These subsequent events may have no relevance or association to the particular material weakness that has been eliminated. Why should the auditor modify the standard report if a significant subsequent event exists regardless of its relevance to the elimination material weakness?

10. We suggest that the Board address what may well become a common practice. This proposed standard allows a subsequent engagement that discusses the elimination of a material weakness after year-end. Assume the year-end is December 31, 2005, management completes its assessment as of February 20, 2006, and the auditor completes its integrated audit on March 8, 2006. Assume management's assessment, or the auditor's feedback to management prior to the completion of the integrated audit, indicates there is a material weakness "as of" December 31, 2005. Management takes immediate action to eliminate the material weakness, and as of March 4, 2006, prior to filing the form 10-K and reports on internal control, the material weakness has been eliminated. Management now requests the optional engagement as specified in this proposal. In this circumstance, what is the desired reporting? In the Form 10-K, management's assessment and the auditor's report will indicate that there is a material weakness "as of" December 31, 2005. May there also be an

auditor's report included in the Form 10-K that states the auditor, in a separate engagement regarding elimination of a material weakness, is of the opinion that the material weakness "as of" December 31, 2005 has been eliminated through the subsequent improvements made by management by March 4, 2006? Can the initial Form 10-K filing include two auditor reports—one that there is a material weakness as of year-end, and the second that the material weakness has been subsequently eliminated? Will this be confusing to users or helpful? Obviously filing the report on elimination of a material weakness should not precede filing of the report disclosing the material weakness, but may these be made concurrently in the initial Form 10-K? We make no recommendation other than that guidance would be appreciated so that practice can evolve as the Board desires. We do note that if the Board believes the initial Form 10-K should not have both the integrated audit report plus the report on elimination of a material weakness, there will be additional filing and subsequent event investigation audit costs will be required for the amended Form 10-K or Form 8-K that will subsequently be required.

If you have any questions, please contact Jim Brown.

Very truly yours,

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