J. Gordon Seymour
General Counsel and Secretary
Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street N.W.
Washington, DC 20006-2803

Re: PCAOB Release No. 2010-001 Rulemaking Docket Matter No. 030
"Proposed Auditing Standard Related to Communications with Audit Committees and related Amendments to Certain PCAOB Auditing Standards"

Dear Mr. Seymour and Board Members:

Lord & Benoit, LLC appreciates the Board reopening the comment period on the proposal until Oct. 21, 2010 regarding the Proposed Auditing Standard Related to Communications with Audit Committees and Related Amendments to Certain PCAOB Auditing Standards.

We are supportive of the Board's efforts to strengthen the communications between auditors and audit committees especially as they relate to protecting the interests of investors. Our premise statement throughout mostly refers to two general concepts… *the audit committee must not only be well-informed of accounting and disclosure matters,* ***but also matters of internal controls*** *over financial reporting****.***

Our viewpoints are best amplified by all of the governing boards, policy makers and regulators which is tha that,

> *"The audit committee provides oversight to the effectiveness of internal control over financial reporting AND financial statement preparation*[1]".
>
> *and…*
>
> *The board's [or Audit Committee's] role is one of governance, guidance and oversight. For publicly listed companies, the board's responsibilities may be*

[1] COSO's 2006 Guidance, Internal Control over Financial Reporting – Guidance for Smaller Public Companies

mandated by law, listing-exchange requirements or charter [such as Sarbanes-Oxley Act Section 404(a)][2]".

For background purposes, I have served on the AICPA Peer Review Acceptance Board in MA for ten years and performed nearly 500 Peer Reviews of CPA firms over the past 20 years. I was also appointed to serve on the most recent Committee of Sponsoring Organizations of the Treadway Commission's (COSO's) Monitoring Project Taskforce[3] representing the interests of smaller companies.

I also am the author of the *Lord & Benoit Reports*[4], was the first evaluator to use the 2006 COSO Guidance for Smaller Public Companies, *the* inventor of Virtual SOX taught on the AICPA Technology website, and research contributor to the SEC Subcommittee Internal Controls Subcommittee to the Advisory Committee on Smaller Public Companies, SEC Concept Releases, SEC Interpretive Guidance Regarding Management's Report on Internal Control Over Financial Reporting, and SEC/PCAOB Internal Control Roundtables.

We thank the Board for considering our comments on this important issue. And we would be please to discuss any of these matters in further detail as well, either at BobB@LordandBenoit.com or by calling (800) 404-7794 x204.

Sincerely,

Robert Benoit

Robert Benoit
President
Lord & Benoit, LLC

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[2] COSO's 2009 Guidance on Monitoring Internal Control Systems [emphasis or clarification added]

[3] However please not that the opinions expressed herein are my own and may not be the opinions of the COSO Board or Taskforce.

[4] Lord & Benoit research has been referenced by the SEC Commissioners and staff, PCAOB Board members, AICPA, IIA, COSO, RIA, CCH, Wall Street Journal, all Big 4 firms and over other 200 newspapers, magazines, legal, educational and trade journals.

Objectives of the Auditor

Question 1. Are the objectives of the auditor in the proposed standard appropriate? If not, why? Should other matters be included in the objectives?

> *We recommend that part (c) which states "providing the audit committee with timely observations arising from the audit that are significant and relevant to the financial reporting process", be expanded "to include the auditors objectives, responsibilities and observations made with respect to the company's management assessment of internal controls over financial reporting[5]" This should enhance evaluating the adequacy of the two-way communications between the auditor and the audit committee and their respective responsibilities to obtain an understanding of and assess the effectiveness of internal control objectives, including those in the audit, through consideration of the importance of accounting policies, practices and use of estimates used to prepare the financial statements.*

Establish a Mutual Understanding of the Terms of the Audit

Question 4. Are there other matters that would enhance investor protection that should be added to an engagement letter? If so, what other matters should be included in an engagement letter?

> *With regards to the requirement to document the understanding with the audit committee of the services to be performed, we recommend adding language concerning internal controls over financial reporting. The 2009 COSO Guidance on Monitoring Internal Control Systems articulates that although management has the primary responsibility for the effectiveness of an organization's internal control system, the Board or Audit Committee's role is one of oversight in governance and guidance in internal controls over financial reporting. We believe these requirements should be set forth in writing.*
>
> *The engagement letter should also document the understanding of responsibilities of both parties (auditor and Audit Committee) when and if a a management assessment (also called a monitoring or separate evaluation), as required by professional standards, has not performed satisfactorily, such as by following the SEC Interpretive Guidance Regarding Management's Report on Internal Control Over Financial Reporting, which is mandated by law, listing-exchange requirements or charter.*

[5] Particularly for those filers that are considered non accelerated filers not subject to auditor attestation of internal controls.

For instance, would the PCAOB Board consider the omission of documenting and testing internal control considered an illegal act under Section 10A[6] *reportable to the shareholders of the company? Or does the omission soley a communication between the auditors and the Audit Committee?*

We believe adding these to the engagement letter "would enhance investor protection" and provide clarity in the event of non compliance.

Obtaining Information Related to the Audit

Question 5. Is the proposed requirement to inquire of the audit committee appropriate? What other specific inquiries, if any, should the proposed standard include for the auditor to make of the audit committee?

In addition to items listed in the proposed Auditing Standard, Identifying and Assessing Risks of Material Misstatement, we suggest the auditor to make inquiries of the audit committee (or its chair) about risks of material misstatement resulting from the entity's documentation and assessment of internal controls over financial reporting.

COSO's 2006 Guidance[7] *contains some useful attributes regarding the role of the board of directors. It says, "The board of directors understands and exercises oversight responsibility related to financial reporting and related internal control. The following three questions relate to the attributes of that principle relate to the board's oversight role regarding monitoring.*

The following are our recommended questions:

1. *Monitors Risk — Has the audit committee (or a competent and objective evaluator within management or outside party) actively evaluated and monitored risks of management override of internal control and considers risks affecting the reliability of financial reporting?*

2. *Oversees Quality and Reliability — Has the audit committee provided oversight to the effectiveness of internal control over financial reporting by ensuring a management assessments of internal controls over the financial statement process was properly documented and tested?*

3. *Oversees Audit Activities — Has the audit committee overseen the work of internal auditors and its responsibilities for meeting internal control related*

[6] Section 10A of the Securities Exchange Act of 1934, *Audit Requirements*, which include investigation of information that indicates illegal acts may have occurred and, upon the satisfaction of certain criteria, reporting illegal acts to management, the Board of Directors, and the SEC.
[7] *, See COSO's 2006 Guidance, page 23*

regulatory requirements, such as Sarbanes-Oxley Act Section 404(a) as necessary?

We suggest requiring these communications, which are consistent with both professional standards and the Proposal to help encourage greater dialogue between the auditor and the audit committee regarding the risks of material misstatement and other matters relevant to both the audit and management's assessment of internal controls.

Overview of the Audit Strategy and Timing of the Audit

Question 6. Are the requirements to provide information on the auditor's audit strategy and timing of the audit appropriate? Does the auditor need more guidance related to the requirement to provide information on the auditor's audit strategy? If so, what type of guidance would be helpful?

With regard to audit strategy, we suggest the Proposal include guidance (or perhaps better clarify) regarding internal control responsibilities for audits of non accelerated filers, which do not require auditor attestation of internal controls over financial reporting.

Professional standards have always required auditors to obtain a sufficient understanding of an entity's internal controls, now including auditor walkthroughs of internal control procedures. This is to obtain a level of assurance that internal accounting control procedures are being applied as prescribed so that the auditor is assured of the validity of underlying evidence. In accordance with AU 319.02, the auditor is to obtain an understanding of internal control sufficient to plan the audit by performing procedures to understand the design of controls relevant to an audit of financial statements and determine whether they have been placed in operation.[8]

PCAOB Auditing Standard No. 5 - An Audit of Internal Control over Financial Reporting states that the audit procedures must be ***integrated*** *with An Audit of Financial Statements. The Board firmly believes that those objectives should be met for the auditor to verify that he or she has a sufficient understanding of the points within the processes where misstatements could occur and to properly identify the controls to test."*[9]

We recommend greater clarity be given to the fact that auditor attestation requirement has been removed for non accelerated filers, but that management's assessment has not been eliminated. And that auditors have a responsibility to perform a walkthrough of company level controls, including monitoring, which is the ongoing monitoring by management of internal controls over financial

[8] http://www.aicpa.org/download/members/div/auditstd/AU-00319.PDF
[9] PCAOB Auditing Standard No. 5 p. 9

reporting for all filers with years ended after Dec 15, 2007. For greater clarity on this last section please see answers to Question 8 on the next page.

AS 5 additionally notes that "Incorporating the auditor's fraud risk assessment – required in the financial statement audit – into the auditor's planning process for the audit of internal control should promote audit quality as well as better integration.[10] Related to that is AU 316.20 and .21 (originating from SAS 99) which states that the auditor should inquire of management about "programs and controls the entity has established to mitigate specific fraud risks the entity has identified, or that otherwise help to prevent, deter, and detect fraud, ***and how management monitors those programs and controls****.*

We believe additional guidance should be provided here with regards to situations where an effective monitoring evaluation is not performed or performed properly.

Or in those cases where a management assessment was properly documented and tested, inquiries should be considered to include whether management has reported to the audit committee or others with equivalent authority and responsibility on how the entity's management assessment of internal controls over financial reporting serves to prevent, deter, or detect material misstatements due to fraud."[11]

Accounting Policies, Practices, and Estimates

Question 8. Are the proposed requirements regarding the auditor's communication responsibilities with respect to accounting policies and practices sufficiently clear in the proposed standard (e.g., is the difference between a critical accounting policy and a significant accounting policy or practice adequately described)?

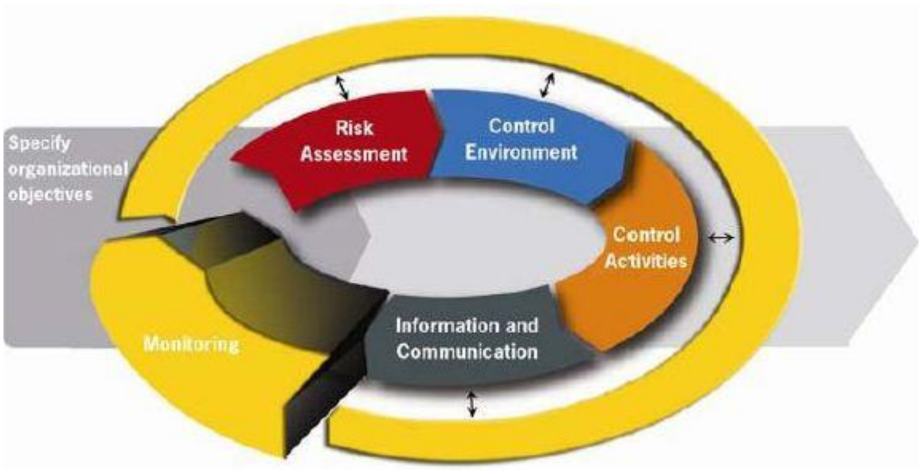
The 1992 COSO Framework states that "monitoring ensures that internal control continues to operate effectively." COSO's 2006 Guidance enhances our understanding of monitoring by articulating that monitoring (one of the five elements of the COSO framework) includes both ongoing monitoring and a separate evaluation. These enable management to determine whether the other components of internal control continue to function over time.

Our point here is that if an entity has not performed an ***effective*** *monitoring by a competent and objective party, the monitoring cannot be reported by management to the Audit Committee (and stakeholders) as effective. And because we are not aware of any other control agent besides the outside auditor, that the Proposal regarding auditor's communication responsibilities should be*

[10] *Ibid.*, p.7
[11] http://www.pcaobus.org/standards/interim_standards/auditing_standards/au_316.html

expanded to include communication of inadequate accounting policies and practices. Or possibly Section 10A provisions.

The following is an example of monitoring the monitoring. The monitoring (as an evaluation or management assessment) is reviewing the ongoing monitoring element of the COSO Guidance[12] (ongoing monitoring by management).



Monitoring Applied to the Internal Control Process
Figure 1

Question 9. Is it helpful to include in the proposed standard the audit committee communications required by the SEC relating to accounting matters?

AICPA CAQ Alert articulated the intended consequences of non-compliance with the management assessment standards, namely, that the failure by management (and its Board who has ultimate oversight responsibility) to complete the evaluation and provide the report as required by Item 308T(a), the company would not be timely or current in its Exchange Act reporting. This would result in the company not being eligible to file new Form S-3 or Form S-8 registration statements and the loss of the availability of Rule 144. Because the filing of the Form 10-K constitutes the Section 10(a)(3) update for any effective Forms S-3 or S-8, the company also would be required to suspend any sales under already effective registration statements.

Additionally, let's say management had not performed an effective monitoring of its internal controls, in the form of a separate evaluation, and by a competent and objective evaluator, as required by both regulatory standards and professional standards, yet communicated to its audit committee that it did in fact do an assessment. In the course of obtaiing and understadnding of the entity's internal controls, outside auditors would in fact become aware that an effective assessment was not done. In communications between auditor and audit

[12] COSO's 2009 Guidance on Monitoring Internal Control Systems

committee, can this in fact be ignored? Can the auditor allow the entity to conclude that internal controls were effective if they did not perform the testing? Can the report to the public conclude they abided by the COSO framework, if they did not document its MONITORING (also called SOX Section 404(a))? .

At a minimum, we believe the proposed standard should require this communication to the audit committee and perhaps be extended to outside parties. We believe Guidance should be developed for the auditor in the event of such a breach in SEC related accounting matters. Our understanding is that such a breach falls under the requirements that of Rule 2-07 of Regulation S-X for the auditor to communicate critical accounting deficiencies in its policies and practices, not only directly to the audit committee, but alternative treatments to investors, as permissible under SEC and PCAOB guidelines for illegal acts, Section 10A.

<u>Other Communication Requirements</u>

Question 19. Are these other communication requirements appropriate and sufficiently clear? What other communication requirements should the proposed standard include, if any?

We believe the proposed standard regarding "Other Information in Documents Containing Audited Financial Statements" should retain the requirement for the auditor to communicate to the audit committee the auditor's responsibility for other information presented in documents containing audited financial statements ***but should be expanded*** *upon by including the management assessment of internal controls over financial reporting.*

Our interpretation of AU section 550, is that auditors should provide reasonable assurance that management's documentation and testing of internal controls over financial reporting was performed in a reasonable manner consistent with the acceptable framework chosen by management (which is typically the Committee of Sponsoring Organizations of the Treadway Commission). Not a full attestation, but at least considering whether it is materially inconsistent.

SEC's RIN 3235-AI54 states that, "The rules also require these officers to certify that: they are responsible for establishing, maintaining and regularly evaluating the effectiveness of the issuer's internal controls; they have made certain disclosures to the issuer's auditors and the audit committee of the board of directors about the issuer's internal controls." [13]

Therefore, it appears that the auditor performing the prescribed course of action stated above, would likely be required to understand whether a company had assessed their internal controls over financial reporting without explicitly testing

[13] http://www.sec.gov/rules/final/33-8124.htm

the entire control environment. The auditor would examine evidential matter, including documentation, to provide reasonable support for management's assessment of the effectiveness of the company's internal controls to mitigate financial statement fraud. And this documentation would normally be a part of an issuer's entire ICFR self assessment.

An instruction to new Item 308 of Regulations S-K and S-B and Forms 20-F and 40-F reminds registrants to maintain such evidential matter.[14]

[14] http://www.sec.gov/rules/final/33-8238.htm#P229_61599