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February 26, 2007

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

Re: PCAOB Rulemaking Docket Matter No. 021

Dear Sir or Madam:

We would like to thank the Public Company Accounting Oversight Board (the “**PCAOB**”) for the opportunity to comment on the issues raised in its proposed Auditing Standards “An Audit of Internal Control Over Financial Reporting that is Integrated with an Audit of Financial Statements and related other proposals” (“**AS5**”) and “Considering and Using the Work of Others in an Audit” (“**AS6**”) of December 19, 2006, and we applaud the PCAOB’s efforts to facilitate more streamlined compliance with Section 404 of the Sarbanes-Oxley Act of 2002 (the “**Act**”) and the rules promulgated thereunder by the Securities and Exchange Commission (the “**Commission**”).

By way of introduction, The Hundred Group of Finance Directors (the “**100 Group**”) represents the finance directors of Britain’s largest companies, mainly but not entirely drawn from the constituents of the FTSE 100 Index of the largest companies by market capitalisation listed on the London Stock Exchange. Almost 40 of our member companies are SEC registrants. We meet periodically to discuss issues affecting major corporations, and selectively respond to governmental and other consultation exercises where we believe that our role in companies and collective experience give us a particular insight into often complex matters.<sup>1</sup>

We acknowledge that Section 404 is designed to improve corporate governance, increase the quality of financial and other disclosure and instill investor confidence in the financial markets. Nevertheless, many market participants and commentators have observed the high cost and burden associated with its implementation. The Commission’s “Staff Statement on Management’s Report on Internal Control Over Financial Reporting” released on May 16, 2005 and the Concept Release Concerning Management’s Reports on Internal Control Over Financial Reporting of July 11, 2006 (the “**Concept Release**”) were important steps in trying to ease the application of Section 404. Our group accepted the Commission’s invitation to comment on the Concept Release and sent in a letter with our views on the questions posed by the Commission on September 15, 2006. The subsequent Commission release regarding “Management’s Report on Internal Control Over Financial Reporting” (the

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<sup>1</sup> While this letter expresses the views of The Hundred Group of Finance Directors as a whole, such views are not necessarily those of individual members or their respective employers.

“Guidance”) and AS5 and AS6 reflect a number of concerns and suggestions we voiced in our comments, and we applaud both the Commission and the PCAOB for their continuing efforts in this regard.

Following the publication of AS5, AS6 and the Guidance, a number of our member companies who are SEC registrants set out to consider the questions posed in both documents. A response prepared at a workshop was subsequently circulated to all members of the 100 Group who are SEC registrants for further comment. We have appended to this letter the 100 Group’s response to the Commission concerning the Guidance. Our comments on AS5 and AS6 and responses to particular questions contained therein are set out below.

- We welcome the Guidance, which contains principle-based guidance for management to fully apply a top-down, risk-based approach to compliance with the Act, enabling management to exercise judgment and expertise in this regard. However, we are concerned that AS5 remains overly prescriptive and does not afford auditors sufficient flexibility to apply their professional judgment in the same fashion as the Guidance permits management to do in its assessment. The outcome of any such divergence between the Guidance and AS5 is likely to be a reduction in the alignment of management’s and the auditors’ own assessment processes, with a corresponding reduction of the potential benefit of the Guidance on the cost/benefit implications of complying with the Act. We therefore request and encourage the PCAOB to consider revising AS5 to be more principle based in nature and to avoid, where appropriate, prescriptive lists that the auditors “should” or “must” consider when conducting their assessment process.
- We recognize that the spirit of the Guidance and AS5 and AS6 is to reduce the high cost and burden currently incurred by registrants in complying with the Act. We consider the thrust of AS5 and AS6 is to offer potential reductions in those costs and burdens. For example we welcome:
  - the omission of the requirement from the new standard that “each year’s audit must stand on its own” (paragraph 2 on page 19 of the Foreword to AS5),
  - the removal of the requirement for the auditor to test controls over a “large portion” of the company (paragraph 3 on page 20 of the Foreword to AS5), and
  - the removal of certain barriers to using the work of others (paragraph 4 on page 21 of the Foreword to AS5).

However, we await demonstrable evidence of its application by auditors before drawing conclusions on whether an actual reduction in cost and burden will be achieved. As such, we encourage the PCAOB in its inspections of audit firms to consider, as a key performance indicator, the extent to which each audit firm has exploited the opportunities for cost savings and efficiency improvements contained in AS5 and AS6.

- We note the removal of the requirement for auditors to opine on management’s evaluation process in complying with the Act, as cited in paragraph B1 on page 14 and at the top of page 17 of the Foreword to AS5, as well as the continued requirement for auditors to opine on the effectiveness of internal control over

financial reporting (“ICFR”) based on their own assessments. We have noted in our response to the Commission that we consider this proposal does not offer the most cost effective outcome in compliance with the Act, believing instead that a requirement for the auditor to provide only an opinion on management’s assessment process would produce the most cost effective solution.

- If the current proposal to remove the requirement for auditors to opine on management’s evaluation process is adopted, the requirement should be supported by the application of a principle-based, top-down and risk-based framework that permits the auditors to apply professional judgment in the performance of a truly integrated audit of ICFR and the financial statements. As such, we would await the final versions of AS5 and AS6, and also evidence of their application by auditors, before we could conclude on the extent to which retaining the requirement for auditors to opine on the effectiveness of ICFR would reduce the cost and burden to registrants of complying with the Act.
- We welcome the increased flexibility offered in AS6 to auditors to use the work of others in arriving at their own assessment on the effectiveness of ICFR. We request consideration as to whether it would be appropriate for management and the auditors to rely simultaneously upon the work of others in instances where testing of the controls relied upon by the auditors is performed with the direct assistance of others, as permitted by paragraphs 20 and 21 on page A2-8 of AS6.
- There are several differences between the definitions and language used in AS5 and those contained within the Foreword; we expect the planned review processes will ensure the full burden-reducing spirit of the Foreword is reflected in the final form of AS5. For example, on page 12 the Foreword to AS5 permits the application of professional judgment by the auditors in their assessment of uncorrected significant deficiencies, whereas the discussion in paragraph 79 on page A1-29 of AS5 appears to remove their ability to apply that judgment.
- With regard to the use of company-level controls in a top-down approach, we request clarification that paragraphs 17 – 22 on pages A1-11 through A1-13 are for illustrative purposes only and do not constitute a mandatory list of items that must be covered during the audit (which again could be perceived as constraining the use of professional judgment by auditors). We also request that the PCAOB recognise that company-level controls assessed using the control framework adopted by management (and the auditor, as stipulated in paragraph 5 on page A1-5) should be selected based on the risk assessment of material misstatements. Furthermore, we request that the PCAOB acknowledge that the selection and application of different weightings of importance to specific entity-level controls will be unique to each organization and may even vary by location within an organization.
- In respect of paragraph 5 on page A1-5, we request that the PCAOB replace the word “should” with “must” in respect of auditors using the same control framework to perform the audit of ICFR as management does.

In addition to the general comments set forth above, we have also prepared responses to specific questions raised in the Foreword to AS5 and AS6 where we felt it appropriate to share our views with the PCAOB.

- **Question 6: Would the performance of a walkthrough be sufficient to test the design and operating effectiveness of some lower risk controls?**

Yes.

- **Question 7: Is the proposed definition of "significant" sufficiently descriptive to be applied in practice?**

Yes.

**Does it appropriately describe the kinds of potential misstatements that should lead the auditor to conclude that a control deficiency is a significant deficiency?**

Yes, but please note our reservations about paragraph 79 on page A1-29 of AS5 set out in the general comments above.

- **Question 9: Will the proposed changes to the definitions reduce the amount of effort devoted to identifying and analyzing deficiencies that do not present a reasonable possibility of material misstatement to the financial statements?**

We believe that proper application of these changes by both management and the auditor would result in a reduction in the amount of effort devoted to identifying and analyzing deficiencies that do not present a reasonable possibility of material misstatement.

We encourage the PCOAB to refine the AS5 definitions of materiality to permit the use of more than one measure of materiality, such as in circumstances where there is a disproportionate relationship between a company's income statement and balance sheet.

- **Question 10: Should the standard allow an auditor to conclude that no deficiency exists when one of the strong indicators is present?**

Yes.

**Will this change improve practice by allowing the use of greater judgment?**

Yes.

**Will this change lead to inconsistency in the evaluation of deficiencies?**

We do not consider that the change will lead to an inconsistency in the evaluation of deficiencies. Instead, it should enable the application of expertise and professional judgment in assessing the individual circumstances that will apply in each evaluation.

- **Question 11: Are further clarifications to the scope of the audit of internal control needed to avoid unnecessary testing?**

We encourage the PCAOB to clarify that the focus of effort and risk assessment is to identify material fraud or potential for material misstatement. The latter is emphasized in a number of places in both the Foreword to AS5 and AS5 itself. We encourage the PCAOB to state clearly that it is only material fraud that should be included in the risk assessment performed during the scoping and evaluation of ICFR.

- **Question 12: Should the reference to interim financial statements be removed from the definitions of significant deficiency and material weakness? If so, what would be the effect on the scope of the audit?**

Section 404 of the Sarbanes-Oxley Act requires an annual “as of” assessment. We therefore consider it inappropriate to review deficiencies using interim financial statements.

- **Question 13: Will removing the requirement for an evaluation of management's process eliminate unnecessary audit work?**

We believe the potential does exist for some unnecessary audit work to be eliminated by this proposal. However, please see our comments in the general response above.

- **Question 14: Can the auditor perform an effective audit of internal control without performing an evaluation of the quality of management's process?**

Yes. However, please see our comments in the general response above.

- **Question 15: Will an opinion only on the effectiveness of internal control, and not on management's assessment, more clearly communicate the scope and results of the auditor's work?**

As noted on page A-17 of the appended response to the Guidance, we understand the Commission’s and the PCAOB’s intention to be to remove the requirement for auditors to give an opinion on the effectiveness of management’s evaluation of ICFR, but find the expression of this intent in AS5 and the Guidance to be confusing in certain respects. For example, the elimination of this requirement does not appear to be fully reflected in the example report on page A1-38 of AS5. If the current proposal for the role of the auditor is adopted in the final Guidance, we would request that the removal of the requirement for auditors to opine on management’s assessment of ICFR in the Foreword to AS5 be clearly reflected in AS5 itself.

- **Question 18: Will the proposed standard's approach for determining the scope of testing in a multi-location engagement result in more efficient multi-location audits?**

We welcome the removal of the requirement for auditors to test controls over a “large portion” of a company, and await demonstrable evidence of the application by auditors of a truly top-down, risk-based approach in determining the scope of testing in a multi-location engagement.

We request that the Note contained within paragraph B12 on page A1-51 be removed from AS5 as it could potentially encourage auditors to consider risk and materiality at a more stringent level to cover the possibility of material misstatement emerging through aggregation of a number of, in themselves, low-risk or immaterial business units or locations.

- **Questions 19 – 25**

**Is the proposed standard's single framework for using the work of others appropriate for both an integrated audit and an audit of only financial statements? If different frameworks are necessary, how should the Board minimize the barriers to integration that might result?**

**Does the proposed definition of relevant activities adequately capture the correct scope of activities, including activities that are part of the monitoring component of internal control frameworks?**

**Will requiring the auditor to understand whether relevant activities performed by others identified control deficiencies, fraud, or financial statement misstatements improve audit quality?**

**Is the principal evidence provision that was in AS No. 2 necessary to adequately address the auditor's responsibilities to obtain sufficient evidence?**

**Does the proposed standard provide an appropriate framework for evaluating the competence and objectivity of the persons performing the testing? Will this framework be sufficient to protect against inappropriate use of the work of others? Will it be too restrictive?**

**Has the Board identified the right factors for assessing competence and objectivity? Are there other factors the auditor should consider?**

**What will be the practical effect of including, as a factor of objectivity, a company's policies addressing compensation arrangements for individuals performing the testing?**

With regard to questions 19-25, AS6 should positively encourage auditors to place reliance on the work of others, as this is the understanding we have derived from both the Foreword to AS5 and AS6 and the Guidance. Encouraging auditors to do this is likely to have a direct and positive impact on the cost and burden of compliance with the Act.

- **Questions 26 and 27**

**Will requiring a walkthrough only for all significant processes reduce the number and detail of the walkthroughs performed without impairing audit quality?**

**Is it appropriate for the auditor to use others as direct assistance in performing walkthroughs? Should the proposed standard allow the auditor to more broadly use the work of others in performing walkthroughs?**

With regard to questions 26 and 27, where testing of controls is performed under the direct assistance of others, as permitted by paragraphs 20 and 21 on page A2-8, we request clarity on whether simultaneous reliance may be placed on this work by management and auditors.

As consistency between the proposed auditing standards and the Guidance is of central importance, the responses we have provided above should be read in conjunction with the 100 Group's response to the Commission concerning the Guidance, a copy of which is attached hereto for your convenience.

Once again, we appreciate the opportunity to comment on AS5 and AS6, and hope that our comments will assist the PCAOB in evaluating the issues raised therein. We are also available to consult with the PCAOB concerning our comments.

Yours sincerely,

Philip Broadley  
Chairman  
The Hundred Group of Finance Directors

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February 26, 2007

Nancy M. Morris, Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

Re: File Number S7-24-06

Dear Ms. Morris:

We would like to thank the Securities and Exchange Commission (the “**Commission**”) for the opportunity to comment on the issues raised in its proposed interpretative guidance, Management’s Report on Internal Control Over Financial Reporting of December 20, 2006 (the “**Guidance**”), and we applaud the Commission’s continuing efforts to facilitate compliance with Section 404 of the Sarbanes-Oxley Act of 2002 (the “**Act**”) and the rules promulgated thereunder by the Commission (collectively, “**Section 404**”).

By way of introduction, The Hundred Group of Finance Directors (the “**100 Group**”) represents the finance directors of Britain’s largest companies, mainly but not entirely drawn from the constituents of the FTSE 100 Index of the largest companies by market capitalisation listed on the London Stock Exchange. Almost 40 of our member companies are SEC registrants. We meet periodically to discuss issues affecting major corporations, and selectively respond to governmental and other consultation exercises where we believe that our role in companies and collective experience give us a particular insight into often complex matters.<sup>1</sup>

Following the publication of the Guidance, a number of our member companies who are SEC registrants set out to consider the questions posed in the Guidance. A response prepared at a workshop was subsequently circulated to all members of the 100 Group who are SEC registrants for further comment. The consensus views that emerged from this process are appended to this letter as Appendix A.

We acknowledge that Section 404 is designed to improve corporate governance, increase the quality of financial and other disclosure and instill investor confidence in the

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<sup>1</sup> While this letter expresses the views of The Hundred Group of Finance Directors as a whole, such views are not necessarily those of individual members or their respective employers.



financial markets. Nevertheless, many market participants and commentators have observed the high cost and burden associated with its implementation. The “Staff Statement on Management’s Report on Internal Control Over Financial Reporting” released on May 16, 2005 and the Concept Release Concerning Management’s Reports on Internal Control Over Financial Reporting of July 11, 2006 (the “**Concept Release**”) were important steps in trying to ease the cost burden associated with the application of Section 404. Our group accepted the Commission’s invitation to comment on the Concept Release and sent in a letter with our views on the questions posed by the Commission on September 15, 2006. The Guidance reflects a number of concerns and suggestions we voiced in our comments, and we applaud the Commission for its continuing efforts in this regard.

Consistent with our response to the Concept Release we recognise the value of the management attestation requirement, and the investor protection benefits generated by the enhanced requirements to assess the effectiveness of internal controls. We also recognise the deterrent effects of the additional civil and criminal penalties adopted in recent years for financial reporting failures.

However, in our response to the Concept Release we noted that the 100 Group did not have complete conviction that the application of the auditor attestation requirement in its current form was worth all of the cost and burden associated with it, due primarily to the duplication of effort by management and auditors in the documentation and testing of controls.

We consider there to be three options for the opinion of the auditor as regards internal control over financial reporting (“**ICFR**”):

1. Retain the current requirement for auditors to opine both on management’s evaluation process and separately opine on their own assessment of the effectiveness of ICFR.
2. Require auditors to opine only on the effectiveness of ICFR, removing the requirement to opine on management’s own evaluation process (as proposed in the Guidance).
3. Require the auditors to opine only on management’s evaluation process, and not provide their own assessment of ICFR.

We consider that the first option does not provide an efficient or effective assessment process and has resulted in the cost and burden of compliance exceeding the benefits derived by registrants and the investor community.

The option proposed in the Guidance, as noted in 2 above, would afford management and the registrant’s board an independent assessment of the effectiveness of ICFR, thus providing some additional comfort in the performance of their fiduciary duties in this regard. Investors may also take additional comfort from an independent assessment of ICFR. The requirement should also offer the potential to reduce some of the cost and burden of complying with the Act, if properly applied in a top-down, risk-based framework that is principle based and that permits the auditors to perform a truly integrated audit of ICFR and the financial statements.

We believe, however, that requiring auditors to opine only on management's own evaluation process (option 3 above) would result in the most cost effective outcome in complying with the Act, primarily through the removal of duplicative documentation and testing requirements on auditors and management. The maximum potential reduction in cost and burden from this option would be realised if auditors were afforded sufficient flexibility to apply professional judgment in the same fashion as the proposed Guidance permits management to do in its assessment process. We also consider that an assessment of management's own evaluation process and the conclusions from that work by the auditor would provide sufficient comfort to registrants and investors with regard to the effectiveness of ICFR. In conclusion, while we would like to reiterate our support for the Commission's efforts to reduce the costs and burdens associated with the Act, we believe that the cost/benefit implications of the Act are better served by requiring the auditor only to opine on management's own evaluation process. As such we would welcome the opportunity to participate in any cost/benefit analysis undertaken by the Commission before finalisation of these proposals.

In addition to the comments above, several general themes and principles run through our comments:

1. The 100 Group supports the thrust of the guidance contained in the Guidance and the goals the Commission is seeking to achieve through this guidance.
2. Consistency with prior Commission guidance and with the proposed PCAOB auditing standards is of critical importance, and we encourage the Commission to consolidate all the relevant releases and guidance into a single, consistent statement of interpretative guidance.
3. If the Commission adopts the current proposal on the role of the auditor in Section 404, the final guidance should clarify and affirm the Commission's and PCAOB's publicly stated goal of eliminating the requirement for auditors to provide an opinion on management's evaluation of internal control over financial reporting, as the Guidance and the related proposed auditing standards of the PCAOB currently contain ambiguities that might cause inconsistent application.
4. We request that the Commission immediately implement the final guidance contained within the Guidance, and give consideration to a retrospective application of the guidance to apply to accounting periods commencing on or after January 1, 2006.

Once again, we appreciate the opportunity to comment on the Guidance, and hope that our comments will assist the Commission in evaluating the issues raised therein. We are also available to consult with the Commission concerning our comments.

Yours sincerely,

Philip Broadley  
Chairman  
The Hundred Group of Finance Directors

cc: Sebastian R. Sperber  
Cleary Gottlieb Steen & Hamilton LLP

## Appendix A

### Section I -- Responses to Questions Posed in Part III, "Proposed Interpretive Guidance" (pp. 49-51)

#### **1. Will the proposed interpretive guidance be helpful to management in completing its annual evaluation process? Does the proposed guidance allow for management to conduct an efficient and effective evaluation? If not, why not?**

We welcome the Commission's proposed principle-based guidance (the "Guidance"), which substantially recognises the concerns raised by registrants about the need to permit management to apply their own top-down, risk-based approach to the evaluation of internal control over financial reporting ("ICFR").

We also broadly support the proposed auditing standards replacing Auditing Standard No. 2, "An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements" ("AS2") (we have commented on specific issues with the proposed standard in our responses below) and await demonstrable evidence of evolving practice of auditors applying a more effective and efficient integrated audit.

However, we have noted in the cover letter to this Appendix that we believe that the ambition of the Commission to reduce the cost and burdens of complying with the Act may be better served by requiring the auditor only to opine on management's evaluation process, and removing the requirement for the auditor to provide a completely separate assessment of ICFR. We believe that this requirement would remove duplicative documentation and testing procedures while maintaining the benefits of improved corporate governance and an independent assessment of ICFR.

Additionally, we encourage the Commission to keep under review any duplication of effort and cost imposed upon foreign registrants by like-for-like regulation in their local jurisdiction, with an eye towards removing duplicative U.S. requirements should local requirements achieve the same purpose.

We request that the Commission and the PCAOB confirm that firms and auditors can begin immediately to apply the final Guidance once issued and that the Commission and the PCAOB will, respectively, themselves apply the Guidance in evaluating filings made on or after January 1, 2006 and in inspections of audit firms. These measures are especially appropriate since several areas of the Guidance reflect that it was always the intention of the Commission and the PCAOB that both the Commission guidance and AS2 should be interpreted as is now set out in the Guidance.

**2. Are there particular areas within the proposed interpretive guidance where further clarification is needed? If yes, what clarification is necessary?**

In addition to our other recommendations made elsewhere herein, we recommend the paragraph on page 44 beginning “In evaluating the magnitude of the potential misstatement . . .” should clarify that due consideration should be given to the risk associated with a control deficiency, and that it is inappropriate simply to focus on the magnitude of the account affected by that control deficiency, as other controls may cover the affected account.

We also disagree with the presumption on pages 44 - 45 that “significant deficiencies that have been identified and remain unaddressed after some reasonable period of time” are a strong indicator of a material weakness. We welcome the application of professional judgement by auditors that can be applied in the consideration of unremediated significant deficiencies in the Foreword to the proposed new auditing standard, “An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements” (“AS5”), and consider the same latitude should be afforded to management, which would be consistent with principle-based guidance and the Commission’s definition of “reasonable assurance” (including footnote 38) on page 15.

**3. Are there aspects of management’s annual evaluation process that have not been addressed by the proposed interpretive guidance that commentators believe should be addressed by the Commission? If so, what are those areas and what type of guidance would be beneficial?**

We request the Commission provide principle-based guidance on documentation and testing standards that will aid management’s judgement in a top-down, risk-based approach that seeks to place reliance on IT application controls and/or IT dependent controls, recognising the difficulty registrants face with the documentation requirements (base-lining) for legacy systems and the ongoing maintenance of that documentation (to reflect changes to ICFR) to support an IT benchmarking testing strategy.

Benchmarking of IT application controls is recognised as being an opportunity to achieve efficiencies in the testing of automated controls. Despite guidance issued on May 16, 2005 by the PCAOB, there are inconsistent interpretations by external auditors as to the nature, extent and timing of benchmarking permitted by management and the benefit that will accrue to the current and future evaluations of ICFR. We request that the Commission provide principle-based guidance on the reliance that management can place on benchmarking of IT application controls to reduce the nature, extent and timing of testing and the evaluation of ICFR.

**4. Do the topics addressed in the existing staff guidance (May 2005 Staff Guidance and Frequently Asked Questions (revised October 6, 2004)) continue to be relevant or should such guidance be retracted? If yes, which topics should be kept or retracted?**

To avoid ambiguity and redundancy, we request the Commission take this opportunity to consolidate all prior guidance and answers to frequently asked questions provided to issuers into one interpretive guidance that is internally consistent.

**5. Will the proposed guidance require unnecessary changes to evaluation processes that companies have already established? If yes please describe.**

No. Principle-based guidance that permits the application of management's judgement is welcomed.



**6. Considering the PCAOB’s proposed new auditing standards, An Audit of Internal Control Over Financial Reporting that is Integrated with an Audit of Financial Statements and Considering and Using the Work of Others In an Audit, are there any areas of incompatibility that limit the effectiveness or efficiency of an evaluation conducted in accordance with the proposed guidance? If so what are those areas and how would you propose to resolve the incompatibility?**

The Guidance affords management the flexibility to apply its own top-down, risk-based approach, enabling management to conduct efficient and effective evaluations. Nonetheless, we observe that there will continue to be dependencies between management’s evaluation and that of the auditors and therefore a need to ensure alignment between the Guidance and AS5 and the other proposed new auditing standard, “Considering and Using the Work of Others in an Audit” (“AS6”). Examples of these dependencies include management structuring their work to ensure efficiency can be achieved by the auditors placing maximum reliance on management’s scoping, documentation and testing. Accordingly, we encourage the Commission through its approval process of AS5 and AS6 to ensure that these auditing standards are made consistently principle based, affording auditors maximum flexibility to use professional judgement in the same fashion as the Guidance permits management to do in its assessment.

A further example of an area where a difference of opinion between management and the auditors could arise is the definition of what constitutes a risk of a material misstatement. This is likely to occur in companies where the balance sheet and income statement are significantly disproportionate and do not justify the application of a single measure of materiality, as is sometimes required by auditors. Using a single measure of materiality in such circumstances makes incompatibility with a risk-based approach more likely. Clarification on the use of multiple materiality levels pertinent to the circumstances of the company would also be welcomed.

We welcome the principle-based approach applied in the Foreword to AS5, but consider the actual language contained in the proposed standard not to fully reflect the intention of the Board of the PCAOB to revise AS2. For example, on page 12 the Foreword permits the application of professional judgement of the auditors in their assessment of uncorrected significant deficiencies, whereas page A1-30 appears to remove their ability to apply that judgement. There are several other similar examples among the definitions and language used in the proposed standard, and we expect the planned review processes will ensure the full spirit of the Foreword is reflected in AS5.

**7. Are there any definitions included in the proposed interpretive guidance that are confusing or inappropriate and how would you change the definitions so identified?**

We request that the Commission define the term “senior management” used on page 45 in the context of “Identification of fraud of any magnitude on the part of senior management”. We consider the definition included in AS5 on page A1-30 to be consistent with principle-based guidance. Accordingly, if the words “the term ‘senior management’ includes the principal executive and financial officers signing the company’s certifications as required under Section 302 of the Act as well as any other members of management who play a significant role in the company’s financial reporting process” were incorporated as a footnote on page 45 this would clarify the scoping and evaluations required by management.

The Commission should incorporate a definition of “prudent official” in the Guidance.

**8. Will the guidance for disclosures about material weaknesses result in sufficient information to investors and if not, how would you change the guidance?**

Yes.

**9. Should the guidance be issued as an interpretation or should it, or any part, be codified as a Commission rule?**

Whether issued in the form of a Commission interpretation or Commission rule we would expect management to be able to rely upon the Guidance in conducting its assessments of internal control over financial reporting. We also strongly support the Commission's proposal to adopt the safe harbour for management conducting its annual evaluation in accordance with the proposed Guidance, and agree that embodying this safe harbour in Rules 13a-15(c) and 15d-15(c) through a rule amendment is appropriate.

**10. Are there any considerations unique to the evaluation of ICFR by a foreign private issuer that should be addressed in the guidance? If yes, what are they?**

We support the guidance in footnote 47 on page 21 that “Management of foreign private issuers that file financial statements prepared in accordance with home country generally accepted accounting principles or International Financial Reporting Standards with a reconciliation to U.S. GAAP should plan and conduct their evaluation process based on their primary financial statements (i.e., home country GAAP or IFRS) rather than the reconciliation to U.S. GAAP”.

Any other issues for foreign private issuers have been reflected in our comments above.

**Section 2 – Responses to Questions Posed in Part IV, “Proposed Rule Amendments” (pp. 52-54)**

**1. Should compliance with interpretive guidance, if issued in final form, be voluntary, as opposed to mandatory?**

Compliance should be voluntary, not mandatory.

**2. Is it necessary or useful to amend the rules if the proposed interpretive guidance is issued in final form, or are rule revisions unnecessary?**

We support the proposed Guidance and the amendments to the Commission rules, subject to the requested clarification on the proposed rule alterations as discussed in our response to question 7 on page A-17 below.

**3. Should the rules be amended in a different manner in view of the proposed interpretive guidance?**

As noted above, we believe that a reduction in the cost and burdens of complying with the Act may be better served by a requirement for the auditor only to opine upon management's evaluation process. We would welcome the opportunity to participate in a cost/benefit analysis before the finalisation of the current proposal to have the auditor separately assess, and opine upon, the effectiveness of ICFR.



**4. Is it appropriate to provide the proposed assurance in Rules 13a-15 and 15d-15 that an evaluation conducted in accordance with the interpretive guidance will satisfy the evaluation requirement in the rules?**

Yes.

**5. Does the proposed revision offer too much or too little assurance to management that it is conducting a satisfactory evaluation if it complies with the interpretive guidance?**

We welcome the principle-based Guidance and consider it appropriate, subject to the observations made above. We encourage the Commission to continue to seek feedback from registrants, investors and auditors (through, for example, roundtable forums) and as appropriate provide additional guidance as practices evolve.

**6. Are the proposed revisions to Exchange Act Rules 13a – 15(c) and 15d – 15 (c) sufficiently clear that management can conduct its evaluation using methods that differ from our interpretive guidance?**

Yes.

**7. Do the proposed revisions to Rules 1-02(a)(2) and 2-02(f) of Regulation S-X effectively communicate the auditor’s responsibility? Would another formulation better convey the auditor’s role with respect to management’s assessment and/or the auditor’s reporting obligation?**

Although in the cover letter to this Appendix and elsewhere in our responses we suggest an alternative approach to the one proposed by the Commission, we make the following comments that would apply if the Commission adopts its proposal as currently worded.

It is our understanding that the Commission’s current proposal is to remove the requirement for auditors to give an opinion on the effectiveness of management’s evaluation process, leaving the auditors to express an opinion directly on the effectiveness of internal control over financial reporting. We have reviewed the language in the proposed rule amendment and consider it to be confusing in certain respects. If the current proposals for the role of the auditor are adopted, we request clarification that all that is required is for the auditor to express an opinion on the effectiveness of ICFR, and that there is no requirement for them to audit, assess or evaluate management’s evaluation and/or assessment process, and/or opine on that process.

We consider the PCAOB’s Foreword to AS5 beginning on page 14, paragraph B, through page 17, which states that “the auditor can perform an effective audit of internal control without conducting an evaluation on the adequacy of management’s evaluation process”, to reflect the public statement made by the PCAOB on 19 December 2006 about “Remov[ing] the requirement to evaluate management’s process”,<sup>1</sup> as well as the Commission’s proposal on page 52 of the Guidance “to require the auditor to express an opinion directly on the effectiveness of ICFR”, rather than on management’s assessment of ICFR. However, the elimination of this requirement does not appear to be fully reflected in the Commission’s proposed rule amendments on pages 67 - 70 or in proposed standard AS5, including the example reports on page A1-38.

We agree with the assertion made in question 15 on page 18 of the Foreword to AS5 to the effect that “an opinion only on the effectiveness of internal control, and not on management’s assessment, more clearly communicate[s] the scope and results of the auditor’s work”. Accordingly, were this proposal for the role of the auditor adopted, we would request the removal of all references in the Commission and PCAOB guidance, and the Rules relating to an “attestation report on management assessment of ICFR” and would recommend replacing this term with an “attestation report on ICFR”. We also request that the words “attest to, and” be deleted from the first sentence of the proposed revision to S-X Rule 210.2-02(f) on page 68 of the Guidance and that the words “indicate that the accountant has audited management’s assessment” be deleted from the second sentence of the same paragraph.

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<sup>1</sup> See [http://www.pcaob.org/News\\_and\\_Events/News/2006/12-19.aspx](http://www.pcaob.org/News_and_Events/News/2006/12-19.aspx).

**8. Should we consider changes to the other definitions or rules in light of these proposed revisions?**

Issuing the clarification requested in previous responses will require conforming changes elsewhere in the interpretive Guidance, proposed rule amendments and AS5.

**9. The proposed revision to Rule-2-02(f) highlights that disclaimers by the auditor would only be appropriate in the rare circumstance of a scope limitation. Does this adequately convey the narrow circumstances under which an auditor may disclaim an opinion under our proposed rule? Would another formulation provide better guidance to auditors?**

Yes, the example is sufficiently narrow.

**Section 3 – Responses to Question Posed in Part VI, “Cost-Benefit Analysis” (p. 56)**

**By encouraging managers to rely on guidance that is less prescriptive and better aligned with the objectives of Section 404, the proposed rule should reduce management’s effort relative to current practice under existing auditing standards. The expenditure of effort by audit firms also may decline, in response, relative to what would occur otherwise. We are thus soliciting comments on how the proposed guidance and the proposed new auditing standard will affect the expenditure of effort, and division of labor, between the managers and employees of public companies and their audit firms.**

We would welcome the opportunity to participate in a cost/benefit analysis of the current proposals, particularly with regard to the current proposals for the future role of the auditor as relates to Section 404.