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Public Company Accounting Oversight Board
Office of the Secretary
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Securities and Exchange Commission
Office of the Secretary
100 F Street, NE
Washington, DC 20549-1090
rule-comments@sec.gov

Re: Rulemaking Docket Matter No. 021
Proposed Auditing Standard – *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements and Related Other Proposals*

SEC File No. S7-24-06
Proposed Interpretation - *Management's Report on Internal Control Over Financial Reporting*

Dear Sir or Madam:

I appreciate the opportunity to respond to the request for comments from the Public Company Accounting Oversight Board (PCAOB) with respect to 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* [PCAOB Release No. 2006-007; PCAOB Rulemaking Docket Matter No. 021] and from the Securities and Exchange Commission (SEC) with respect to its Proposed Interpretation – *Management's Report on Internal Control Over Financial Reporting* [SEC Release Nos. 33-8762; 34-54976; File No. S7-24-06]. My comments provided are based on my insights and experiences in performing integrated audits at a Big Four public accounting firm and participating in management's assessment of internal controls over financial reporting (ICFR) within a Fortune 100 company when serving as a Director of Financial Compliance.

I support the PCAOB's efforts to clarify Auditing Standard No. 2 and align this standard with the interpretive guidance proposed by the SEC. Overall, I strongly agree with a principles-based approach to the internal control assessment and employing a top-down risk-based approach that requires testing of operating effectiveness of only ICFR necessary to prevent or detect *material* misstatements in the financial statements. However, I believe additional consideration, emphasis, and clarification is required with respect to some areas. To that end, I offer the following comments and observations for your consideration.

Thank you for the opportunity to comment on these proposed standards and interpretation. If you have any questions, please do not hesitate to call me at (626) 378-1923.

Respectfully Submitted,

Jeffrey M. Monohan

Comments

PCAOB Proposed Auditing Standard – *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements and Related Other Proposals*

Questions

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

Removing the requirement for an evaluation of management's process will eliminate some unnecessary audit work. However, the extent of this elimination will be minimal. To obtain any efficiencies from leveraging efforts of management's assessment with the independent auditor's assessment over ICFR, management's process will have to operate at a level of quality (considering nature, timing, and extent of work performed by management and the competence and objectivity of those performing the operating effectiveness of ICFR) that would be acceptable to the independent auditor to allow the auditor to rely on as much of management's work as possible over processes considered having low to moderate risk. If the auditor decides to utilize management's work in these areas, the auditor will require reperformance of portions of management's work. The aforementioned is not much different from what is being performed today.

Eliminating the independent auditor's evaluation of management's process will more than likely encourage the auditor not to use management's work. There is little benefit for the independent auditor to use management's work. Managing one's risk and liability associated with an audit is an integral part of an independent auditor's business model. Why would an auditor place greater exposure on himself or herself and reperform portions of *management's work* when applying the principles of "considering and using the work of others in an audit" in an effort to reduce his or her own work? Unless an independent auditor reperforms a substantial portion of management's work, how can an auditor obtain reasonable assurance that the work performed in a particular area is adequate and can be relied upon for the independent auditor's opinion of ICFR? It is more practical that an independent auditor would gain greater assurance over his or her own work over testing the necessary audit sample to determine operating effectiveness of ICFR than reperforming portions of management's work (even considering that the auditor reperforms portions of management's work and appropriately applies the principles of the proposed auditing standard over considering and using the work of others in an audit). In addition to the obvious monetary benefit generated through audit fees for performing the necessary work associated with the assessment of ICFR by himself or herself, the independent auditor can reduce audit risk by performing all necessary work to substantiate his or her audit opinion over ICFR.

Although the requirement for an independent auditor's opinion on management's assessment process is being proposed for elimination, the duplication of work and associated costs (management process owners effectively still will get tested twice—as a result of procedures related management assessment of ICFR and the independent auditor's assessment of ICFR) will remain. The independent auditor will continue to employ a conservative approach and cause similar inefficiencies as in past years. Management could encourage the independent auditor to employ the necessary principles and procedures to have the auditor consider and use the work of others, but the auditor always has the option to decide not to for various reasons. Through the PCAOB inspections of the audits performed by the independent registered public accounting firms, PCAOB inspectors are focused on the quality of the audit performed. The PCAOB inspectors cannot detect that the auditor has not appropriately leveraged management's work when management's work meets all the principles stated in its proposed auditing standing of "Considering and Using the Work of Others in an Audit." This would be beyond the scope of the PCAOB's inspection. Therefore, there is little that can be done to stop these inefficiencies. Management will continue to be plaque by the duplication of efforts created by its and the independent auditors assessment of ICFR.

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?

The proposed standard's approach needs additional clarification. A combined coverage (similar to AS2 Appendix B4. – "a large portion of a company's operations and financial position") in conjunction with the degree of risk associated with a location or business unit will allow for greater flexibility and efficiencies for management and its independent auditors. The inclusion of AS2 Appendix B4. language in combination with assessing risk of material misstatement would provide greater clarification.

Question 34. How can the Board structure the effective date so as to best minimize disruption to on-going audits, but make the greater flexibility in the proposed standards available as early as possible? What factors should the Board consider in making this decision?

Although many concepts of the proposed standards can be implemented currently, the proposed standards would need to be approved by May 31, 2007 in an effort to obtain maximum benefit to audits for years ending on or after November 30, 2007. This timing would provide management and its independent auditor sufficient time to plan and effectively implement the proposed changes.

<u>Observation</u>

Management's need to report all control deficiencies to the independent auditor

Within paragraph 84 (e) of the proposed standard, it states that management should disclose to the auditor *all deficiencies* in the design or operation of ICFR identified as part of management's assessment. This would include deficiencies, significant deficiencies, and material weaknesses. However, according to the SEC Proposed Interpretation the purpose of management's assessment is to assess whether there is a reasonable possibility of a *material* misstatement in the financial statements not being prevented or detected on a timely basis. As such, management would only be able to disclose with reasonable assurance to the auditor significant deficiencies or material weaknesses over ICFR if management employed an assessment process to achieve compliance with the SEC Proposed Interpretation. I would recommend that references to management's disclosure of deficiencies be restricted to significant deficiencies and material weaknesses to avoid any unintended inefficiencies.