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Comptroller General
of the United States

United States Government Accountability Office
Washington, DC 20548

July 12, 2007

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

Subject: File No. PCAOB-2007-02—Solicitation of Comments on the Filing of Proposed Rule on Auditing Standards No. 5, An Audit of Internal Control over Financial Reporting That is Integrated with an Audit of Financial Statements, and Related Independence Rule and Conforming Amendments

This letter provides the U.S. Government Accountability Office's (GAO) comments on the Securities and Exchange Commission's (SEC) Solicitation of Comments on the filing of the proposed rule for an audit of internal control over financial reporting that is integrated with the audit of financial statements. On February 26, 2007, we sent a letter to the Public Company Accounting Oversight Board (PCAOB) laying out our concerns with its December 19, 2006, draft of this proposed auditing standard.

Overall, we support the proposed rule and believe that it resolves many of our concerns related to Auditing Standard No. 2, An Audit of Internal Control over Financial Reporting Performed in Conjunction with an Audit of Financial Statements. We especially support

- the adoption of a more principles-based approach and a corresponding reduction in prescriptive detail throughout the standard, and

- the decision to retain the existing standard on the auditor's use of the work of others in an integrated audit, rather than adopting a new standard as proposed in the December 2006 PCAOB Exposure Draft.

In addition to the comments in our February 26, 2007, letter we are concerned with the implications of question 3 in the SEC Solicitation of Comments, which asks:

> Is AS 5 sufficiently clear that for purposes of evaluating identified deficiencies, multiple control deficiencies should <u>only</u> be looked at in combination if they are related to one another? [underlining added for emphasis]

This question appears to refer to the second note in paragraph 65 of AS No. 5, which states:

> Multiple control deficiencies that affect the same financial statement account balance or disclosure increase the likelihood of misstatement and may, in combination, constitute a material weakness, even though such deficiencies may individually be less severe. Therefore, the auditor should determine whether individual control deficiencies that affect the same significant account or disclosure, relevant assertion, or component of internal control collectively result in a material weakness.

Question 3, when read in conjunction with the second note in paragraph 65 of AS No. 5, could be interpreted to imply that management and auditors should consider whether multiple deficiencies constitute a material weakness <u>only</u> when the deficiencies affect the same significant account or disclosure, relevant assertion, or component of internal control. We do not believe that such an interpretation would be appropriate. Suggesting that multiple control deficiencies may, in combination, constitute a material weakness <u>only</u> if the same significant account or disclosure, relevant assertion, or component of internal control is affected would be overly prescriptive and could result in failure of management and auditors to identify and report material weaknesses. In fact, multiple control deficiencies in multiple account balances or disclosures can, in the aggregate, constitute a material weakness. To avoid misinterpretation, we recommend revising the second note in paragraph 65 of AS No. 5 as follows:

> Multiple control deficiencies that affect the same financial statement account balance or disclosure increase the likelihood of misstatement and may, in combination, constitute a material weakness, even though such deficiencies may individually be less severe. Therefore, the auditor should determine whether individual control deficiencies that affect the same significant account or disclosure, relevant assertion, or component of internal control collectively result in a material weakness. It's also important to keep in mind that multiple deficiencies affecting multiple accounts or disclosures can, in the aggregate, result in a material weakness.

Also, we noted several references to AU sections in AS No. 5 that do not indicate whether the reference is to the AICPA Codification of Statements on Auditing Standards or to the PCAOB interim standards. Specifically, AS No. 5 includes references to AU sec 312 in paragraph 20, footnote 11 and in paragraph 31, footnote 13 and to AU section 326 in paragraph 28, footnote 12. These sections of the AICPA Codification have been significantly revised by Statement on Auditing Standard (SAS) 107, Audit Risk and Materiality in Conducting an Audit, and SAS 106, Audit Evidence. The AICPA has issued 13 new auditing standards since the PCAOB adopted its interim standards on April 16, 2003, resulting in numerous other differences between the PCAOB interim standards and the AICPA Codification.

At a minimum, AS No. 5 should clarify which AU section is being referenced. Furthermore, as we noted in our May 18, 2007, letter to the PCAOB, we strongly believe that U.S. auditing standard setters should work together to achieve consistency on core auditing standards that are used by almost all auditors of U.S. entities.

We thank you for considering our comments on these very important issues and look forward to working with you to promote high-quality auditing in the United States.

Sincerely yours,

David M. Walker
Comptroller General
of the United States

Enclosure

cc:
The Honorable Christopher Cox, Chairman
U.S. Securities and Exchange Commission

The Honorable Mark W. Olson, Chairman
U.S. Public Company Accounting Oversight Board

Conrad W. Hewitt, Chief Accountant
U.S. Securities and Exchange Commission

Harold Monk, Jr., Chair,
U.S. Auditing Standards Board