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July 12, 2007

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

RE: File Number PCAOB 2007-02 Notice of Additional Solicitation of Comments on the Filing of Proposed Rule on Auditing Standard 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

Dear Ms. Morris:

The Center for Audit Quality (CAQ or the Center) is a group created by the public company auditing profession and the American Institute of Certified Public Accountants to help foster confidence in the audit process and aid investors and the capital markets by advancing constructive suggestions for change rooted in the profession's core values of integrity, objectivity, honesty and trust. The CAQ consists of approximately 800 member firms that audit or are interested in auditing public companies. We welcome the opportunity to share our views on the Securities and Exchange Commission's (SEC or Commission) additional solicitation of comments on the filing of proposed rule on the Public Company Accounting Oversight Board's (PCAOB or the Board) Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements (AS 5)*, and Related Independence Rule and Conforming Amendments.

The Center commends the PCAOB's diligent efforts that went into its decision to adopt a new standard regarding the auditing of internal control over financial reporting. We believe the new auditing standard, along with the SEC's adoption of guidance for management's Section 404 report, include significant investor safeguards and will make implementation of Section 404 of the Sarbanes-Oxley Act more effective and efficient.

We also commend the PCAOB for placing increased emphasis and flexibility on the auditor's use of professional judgment, and its decision to apply a single model of auditor reporting on internal control over financial reporting that is scalable depending on a company's size and complexity.

We encourage the Commission to expedite final approval of AS 5 to facilitate its implementation for all integrated audits.

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We are pleased to respond to your request for feedback by addressing each of the SEC's questions on this matter as follows:

(1) Is the standard of materiality appropriately defined throughout AS5 to provide sufficient guidance to auditors? For example, is materiality appropriately incorporated into the guidance regarding the matters to be considered in planning an audit and the identification of significant accounts?

We believe that the standard of materiality is appropriately referenced throughout AS 5. AS 5 states that auditors should use the same materiality in planning the audit of internal control over financial reporting that is required in planning the financial statement audit (see Paragraph 20). We believe that emphasizing this point will promote an integrated audit that is conducted in the most effective and efficient manner.

(2) Please comment on the requirement in Paragraph 80 that the auditor consider whether there are any deficiencies or combinations of deficiencies that are significant deficiencies and, if so, communicate those to the audit committee. Specifically, will the communication requirement regarding significant deficiencies divert auditors' attention away from material weaknesses?

The requirement stipulated in Paragraph 80 should have no bearing on the scoping judgments. Accordingly, we believe that this communication requirement regarding significant deficiencies will not divert auditors' attention away from material weaknesses. In addition, we believe that Paragraph 3 of AS 5 clearly indicates that the auditor should plan and perform the audit to identify material weaknesses, not significant deficiencies.

(3) Is AS5 sufficiently clear that for purposes of evaluating identified deficiencies, multiple control deficiencies should only be looked at in combination if they are related to one another?

We believe that the note included in Paragraph 65 of AS 5 provides adequate guidance for auditors when considering whether multiple internal control deficiencies constitute a material weakness. Specifically, the note to Paragraph 65 states that multiple control deficiencies "that affect the *same* financial statement account balance or disclosure" may increase the likelihood of misstatements and may constitute a material weakness. This note further states that auditors should evaluate whether deficiencies "that affect the *same* significant account or disclosure, relevant assertion, or component of internal control collectively result in a material weakness." (Emphasis added.) These statements make it clear that only related deficiencies should be combined. In addition, we believe that the aggregation of internal control deficiencies has not presented a significant challenge for management or auditors in practice.

(4) Please comment on whether the definition of "material weakness" in Paragraph A7 (which is consistent with the definition that the SEC adopted) appropriately describes the deficiencies that should prevent the auditor from finding that ICFR is effective.

We believe that the definition of "material weakness" in AS 5 is appropriate.

(5) Is AS5 sufficiently clear about the extent to which auditors can use the work of others?

We believe that AS 5 is sufficiently clear about the extent to which auditors can use the work of others. As we communicated in our comment letter dated February 16, 2007 to the Board on their initial exposure of AS 5, we believe that effective and efficient implementation of Section 404 in this area can be achieved through the proposed changes to AS 2 coupled with the existing requirements in AU sec. 322 "*The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*." As a result, we believe that the requirements and guidance in AS 5 relative to using the work of others, Paragraphs 16 through 19, coupled with the existing AU sec. 322, provide sufficient flexibility when considering whether, and to what extent, to use the work of others in an integrated audit.

(6) Will AS5 reduce expected audit costs under Section 404, particularly for smaller public companies, to result in cost-effective, integrated audits?

With respect to smaller accelerated filers, we expect that AS 5, along with the SEC's management guidance on the assessment of internal control over financial reporting, will result in a reduction of total Section 404 costs (internal and external), including audit costs, from what they would have been had AS 5 and the SEC guidance for management not been issued for those issuers that have previously implemented Section 404. We believe that the scope of these reductions in effort and their relative balance between management effort and auditor effort, likely will vary significantly based on facts and circumstances for each particular company. Factors that will affect these reductions include the state and quality of an issuer's control structure, the degree of centralization and complexity of its operations, the risks inherent in its business model, and the adjustments in scope and collaboration that already have occurred during the past three years of implementing the requirements of Section 404.

We expect that the maximum opportunities for efficiencies and cost-effectiveness in Section 404 implementation can be obtained when management and auditors work together to conduct their assessments in a complementary manner, particularly when the auditor can effectively use the work of others.

With regard to the non-accelerated filers, costs will increase due to the simple fact that they have no Section 404 costs today because they have not yet implemented. However, those costs will be less than they would have been had AS 5 and the SEC's management guidance not been issued. These companies and their auditors also will benefit from the lessons learned by accelerated filers and their auditors in the first three years of Section 404 implementation. Accordingly, we believe that the learnings gained by accelerated filers in the first three years of Section 404, coupled with the SEC guidance for management and AS 5, will result in a more efficient and less costly "Year 1" for the non-accelerated filers. In addition, we believe that the PCAOB's project to develop guidance and education for auditors of smaller public companies that is supported by many of the member firms of the CAQ, along with the Committee of Sponsoring Organizations of the Treadway Commission's (COSO) project to develop guidance designed to help organizations monitor the quality of their internal control systems and other COSO guidance directed to smaller public companies, will facilitate implementation of Section 404 in an effective and efficient manner.

As we noted in our February 16, 2007 comment letter to the Board, we continue to believe that the benefits from the SEC and PCAOB proposals will be greatest to companies that have not yet initially implemented the requirements of Section 404, such as non-accelerated filers and new public companies.

(7) Does AS5 inappropriately discourage or restrict auditors from scaling audits, particularly for smaller public companies?

We do not believe that AS 5 inappropriately discourages or restricts auditors from scaling audits, particularly for smaller public companies. We commend the PCAOB in developing a standard that is appropriately scalable to companies of varying size and complexity. We believe that the PCAOB's project to develop guidance and education for auditors of smaller public companies as we noted above will facilitate scalability of integrated audits in an effective and efficient manner.

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We appreciate the opportunity to provide our feedback on the SEC's request for comment on the filing of proposed rule on the Board's AS 5 and would welcome the opportunity to meet with you to clarify any of our comments.

Sincerely,

Cynthia M. Fornelli
Executive Director
Center for Audit Quality

cc: SEC
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