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It is very encouraging that the PCAOB has recognized that the benefits of Section 404 have come at a disproportionately high cost. Its efforts to bring cost into line and be exceeded by the benefits of Section 404 are to be commended. Should the proposed auditing standard be implemented as proposed, it will improve the cost/benefit relationship, but several hurdles will remain. Some hurdles will be within the PCAOB's ability to control, and others outside:

1. Will the PCAOB field offices follow the proposed audit standard in conducting audits of external auditors? Attention by the PCAOB National Office in training its field staff in protecting against not just poor audit quality, but from excessive audit cost, is appropriate.

2. Will the external auditors accept the new audit standard in spirit? For most external audit firms, the new audit standard will likely reduce public company client billings and a natural reluctance to reduce their income substantially should be anticipated.

3. Will the audit standards be accepted by the courts and juries in dealing with the class action plaintiff's bar, or will external auditors be expected to adhere to higher audit levels than the PCAOB sets forth? The external auditors can be expected to resist reducing their procedures and fees for this reason, and with considerable merit as in practice they are serving as an investor insurance carrier. Comments from KPMG during their 404 Institute webcast of December 18, 2007 stated that while management efforts could decrease under the proposal, external auditor efforts (which are far more costly than internal efforts) could increase significantly to make up for the decreased management efforts.

4. Congressional or judicial action to limit the actions of the plaintiff's bar, who are seemingly sailing under Letters of Marque and Reprisal (Article I, Section 8 of U.S. Constitution), and moving securities violations prosecution from the private sector to governmental authority would be helpful in reducing system cost. This would assist in more rational audit behavior by the external audit firms who are reacting like a lamb in the midst of a pack of hyenas: the occasional bleat followed by a merciless slaughter [(1)].

5. Following the Canadian example of not having the auditors opine on ICFR would also be helpful, though it would require Congressional action to eliminate the independent certification requirement of Section 404. The Company (the Board) would still formally attest to ICFR. Boards rarely undertake economic exposure without significant due diligence, and in Canada practice is evolving that Boards ask the external auditor to conduct an assessment of management's assertions on ICFR. The objective is to remove the litigation exposure of the external auditor and thereby significantly reduce auditor costs while improving internal control.

The Proposed Auditing Standard has 34 questions that the Board seeks comments on; the following are responses to some of those questions.

 # 3: Will the top-down approach better focus the auditor's attention on the most important controls?

Yes. The top down approach should produce far more focused and effective reviews of ICFR. The current approach is backward in identifying materiality and decreases audit efficiency by having first to identify all transactional activity, then ferreting out the material.

#5: Does the proposed standard appropriately incorporate risk assessment, including in the description of the relationship between the level of risk and the necessary evidence?

Yes. The proposed standard does appropriately incorporate risk assessment as it uses a top down approach.

#7: Is the proposed definition of "significant" sufficiently descriptive to be applied in practice? Does it appropriately describe the kinds of potential misstatements that should lead the auditor to conclude that a control deficiency is a significant deficiency?

Response combined with question #9 below.

[(1)] The current defendants of the predatory bar could identify well with the victims of the Aragonese Archbishop of Narbonne, Arnold Amaury, who in the early 1200's said in response to a question about distinguishing Cathar (Albigensian Christians) from Catholic, "Kill them all, God will know his own". The contemporary version, in a turn of "capital" punishment, might be "Sue them all, let the courts sort it out".

#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?

Materiality (reasonable possibility, significant) now appears coordinated with SEC SABs 99 and 108 and that consistency is positive. However, many regard the SEC materiality guidance as flawed as they result in restatements that investors consider immaterial. For simplicity, the new PCAOB guidance should track to whatever the SEC determines is the appropriate level of materiality, whether it is the current method or some new metric. This would leave struggling with materiality to the SEC.

#10: Should the standard allow an auditor to conclude that no deficiency exists when one of the strong indicators is present? Will this change improve practice by allowing the use of greater judgment? Will this change lead to inconsistency in the evaluation of deficiencies?

One would expect that a restatement (one of the strong indicators) would normally be evidence of a material weakness in ICFR. Nonetheless, an event theoretically could occur where a restatement did not lead to a material weakness. If management, the audit committee, board and external auditor all concur that there was no material weakness, then it may be appropriate to conclude a material weakness was not present. It seems reasonable that the Standard should permit such a finding, though the occurrence of such findings would be rare, particularly if the SEC re-addresses materiality to reduce the amount of immaterial restatements.

#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?

Yes. As the attestation to ICFR is on an annual basis, the relevance of interim materiality would seem moot unless there was a significant interim failure in ICFR. If there were a significant interim period failure in ICFR (for instance, a restatement) materiality should remain the same dollar value as annual periods.

The PCAOB should avoid the difficulties that the SEC finds itself in when attempting to apply percentage materiality to interim periods and either missing a material item, or more often, finding more material items than exist. Both the SEC and PCAOB need to recognize that a material percentage of a financial statement number may or may not result in a material valuation change in shareholder value. Shareholders are concerned with the DCF of future cash flows and if the error materially affects those flows investors are quite concerned. If they are merely backward looking classification errors that will not affect future cash flows, then one should expect investors to exhibit far less concern unless the error is indicative of incompetent or unethical behavior.

The purpose of ICFR is not just annual periods, however the determination of materiality for an interim period is an area that the SEC needs to address further as SABs 99 and 108 can result in immaterial items causing restatements. The PCAOB should not compound the problem by developing a materiality standard different from the SEC definition, but track to that definition, even if flawed, and use that definition on an annual basis only.

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

Yes. Removing the requirement for an evaluation of management's process will eliminate unnecessary audit work. However, as the appropriate number of auditor hours are opaque to most companies, how much will be removed is uncertain. A pessimist would observe that the applicable audit hours were considerable before the external auditor found those hours were being removed, and after removal that the hours were immaterial; thus hours and fees will remain unjustifiably high.

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

Yes. The question for purposes of the attestation is the quality of the controls, not the means by which those controls were attained. The auditor can contribute value without a formal report on management's process.

Shareholders should be able to expect that an auditor would comment to management (¶ 87) and the audit committee about the quality of ICFR to point out areas where the company is just passing, or incurring excessive costs or procedural hours in achieving a control objective. The external auditor should be encouraged, preferably required, to comment on the quality of ICFR to management and the audit committee; not just that the company passed or failed.

#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?

Yes. Simplicity imparts clarity.

#19: (a) 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? (b) If different frameworks are necessary, how should the Board minimize the barriers to integration that might result?

(a) Yes, (b) no comment submitted at this time.

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

Yes. The question is whether external auditors can perform the task economically in relation to the risks – including the risks to the company as well as to the audit firm from litigation.

#23: (a) Does the proposed standard provide an appropriate framework for evaluating the competence and objectivity of the persons performing the testing? (b) Will this framework be sufficient to protect against inappropriate use of the work of others? (c) Will it be too restrictive?

(a) Yes, (b) Yes, though it will obviously depend on the application of the spirit of the framework by the external auditor, (c) No.

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

Yes. Both education and experience are appropriate elements to be considered, though formal education (or its lack) alone should not preclude consideration of experience. The complexity of the audit or control area should dictate the appropriate combination of education and experience.

#25: 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?

Positive. Conceptually, Internal Auditors and others involved in the assessment of ICFR should be independent of the outcome of the ICFR audit, including financial independence. The compensation of Internal Audit staff should be independent of the results of the audit, though audit efficiency and efficacy could fairly be considered in bonus plans.

#32: Are the market capitalization and revenue thresholds described in the proposed standard meaningful measures of the size of a company for purposes of planning and performing an audit of internal control?

"Market capitalization" should be clarified to be "equity market capitalization" utilizing a definition of equity consistent with that contained in Securities Exchange Act Rule 12b-2. The use of revenue as a defining measure does not appear to necessarily relevant to shareholder risk – shareholders invest in equity instruments, not in sales. There are numerous industries (particularly more mature industries, but not exclusively) that have high revenues and low gross and net margins, and accordingly lower equity values; at the same time there are companies with small revenues but the market attributes great expectations to future cash flow growth and assigns very large equity valuations. Shareholder risk is correlated with equity value, not sales volume.

The Securities Exchange Act Rule 12b-2 definitions for non-accelerated (<$75m), accelerated (>$75m, <$700m) and large accelerated (>$700m), which use the amount of

outstanding equity instruments not held by an affiliate, are reasonable size determinates are suitable for use by the PCAOB. Using the SEC definitions would also avoid yet another size definition for preparers and users to deal with.

The SEC itself may wish to move in the direction of the Advisory Committee report describing "Smaller Public Companies" as those with under $787.1 million in [equity] market capitalization (bottom 6% of public companies) and "Microcap Companies" as those Smaller Public Companies with [equity] market capitalization under $128.2 million (bottom 4% of public companies) as a very good starting point. Whether it is the SEC or the PCAOB that sets the thresholds, they should round the amounts up to provide an easier reference, perhaps using the thresholds of greater than $800 million or $1 billion for "Smaller Public Companies" and under $200 million or $150 million for "Microcap Companies". Further, the Agency setting the level (SEC or PCAOB) should schedule reconsideration of the definition thresholds not less often than every five years to reflect inflation and market developments, and changes should be in large amounts (e.g., minimum $100 million for Smaller and $25 million increments for Microcap companies).

It would seem appropriate for the SEC to set the threshold levels and for the PCAOB to track the SEC levels.

#33: Is there other information the auditor should provide the audit committee that would be useful in its pre-approval process for internal control-related services?

I have not seen difficulties in this area from the company perspective; auditors may see greater issues in the loss of revenue from conflicted services. The projected cost of the proposed service and relationship to the projected audit fee would be valuable for the Audit Committee to know. However, anecdotal comments indicate external auditors are currently reluctant to provide many audit committees with estimates of audit fees.

#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?

Any date selected will be disruptive – either the date will be too late to alter ICFR audit practices to eliminate inefficient ICFR audit practices, or too soon for some audits that might require a significant change in process. A reasonable approach set the effective date for fiscal years ending on or after December 15, 2007, and to permit early adoption. This approach would allow companies to make the determination of whether early implementation would provide the most practical and economic means of making the change.

Thank you for the consideration of the above comments in your process of improving the auditing requirements related to Sarbanes-Oxley Section 404.

Sincerely,

/s/ James Wall

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