To: Office of the Secretary
Public Company Accounting Oversight Board

Re: PCAOB Rulemaking Docket 21
From: Monica Radu
Date: February 4, 2007

Dear Board Members,

Thank you for the opportunity to comment on the Board's Proposed Standard, it is greatly appreciated.

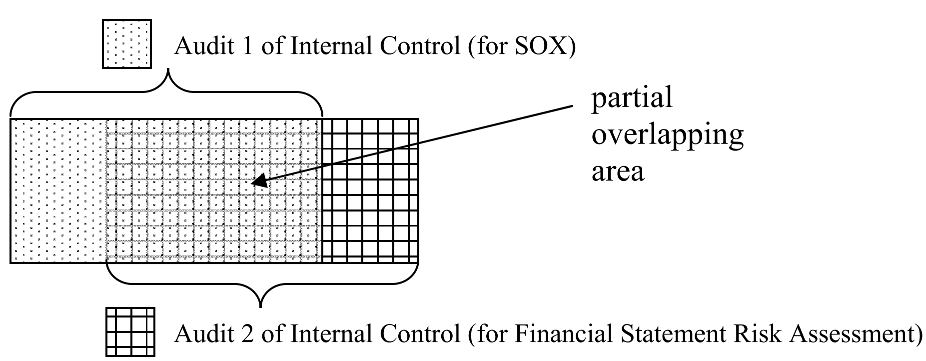
<u>*Scope of Comment*</u>
I would like to comment on appendix B, paragraphs B1-B11, "Integration of Audits", which is describing the interrelationship of two Audits of Internal Control namely:
Audit 1: an Audit of Internal Control over Financial Reporting (for SOX Audit) and
Audit 2: an Audit of Internal Control for Internal Control Risk Assessment (for Financial Statement Audit).

<u>***Thesis***</u>
I would like to propose that the distinction between the two Audits is only in the purpose for which they are used, not in the work performed. Therefore, they are in fact one and the same Audit of Internal Control, which satisfies two purposes; and by performing the work described in the Proposed Standard, both purposes would have been accomplished.

<u>*Background*</u>
The Proposed Standard is making a between two Audits of Internal Control:
Audit 1: an Audit of Internal Control over Financial Reporting (for SOX Audit) and
Audit 2: an Audit of Internal Control for Internal Control Risk Assessment (for Financial Statement Audit).

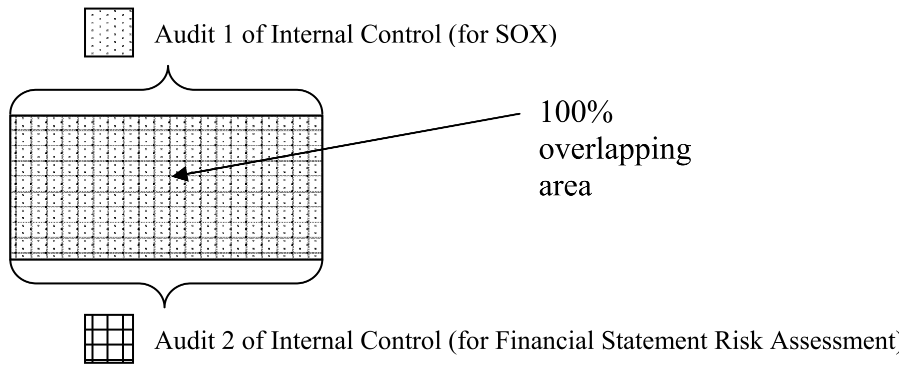
This distinction can be seen in paragraphs such as B4: "This requires that the auditor test the design and operating effectiveness of controls he or she would not test if expressing an opinion only on the financial statements" or B5: "the auditor should incorporate the results of any additional tests of controls performed to achieve the objective related to expressing an opinion on the financial statements". Based on these paragraphs, the Proposed Standard's current view of the two Audits of Internal Control can be graphically represented as follows (with some overlap but also some differences):

Current view:



Argument
I would like to propose that the two Audits of Internal Control are one and the same Audit of Internal Control. The reasons are stated in paragraphs I, II and III below. A graphical representation of the proposed view is as follows:

Proposed view:



Reason I. The same work is performed for both Audits. This is evidenced by:

A) the same methodology (the Proposed Standard and SAS 55, SAS 78, and AU 319)
The methodology described in the Proposed Standard for Audit 1 of Internal Control (for SOX), is the same as the methodology established in SAS 55 and 78, and AU section 319 for Audit 2 of Internal Control (for Financial Statement Risk Assessment).

B) the same underlying base (Financial Statements and Disclosures)
Both Audit 1 and Audit 2 are of Internal Control over Financial Reporting (preparation of Financial Statements and related Disclosures)

C) the same materiality threshold level (reasonable possibility of material misstatement)
Both Audit 1 and Audit 2 use the same materiality considerations, per the Proposed Standard paragraph 14: "in planning the audit of internal control over financial reporting, the auditor should use the same materiality considerations he or she would use in planning the audit of the company's annual financial statements".

D) the same scope (based on B) and C) above, combined)
As both the underlying base and the materiality threshold level are the same for both Audits, it means that their scope is the same (the same assertions, processes, accounts, disclosures, classes of transactions, risks, controls, etc are relevant for both Audits)

E) by definition
By definition, "Assessing control risk is the process of evaluating the effectiveness of an entity's internal control in preventing or detecting material misstatements in the financial statements" (AU 319.64) By this definition, Control Risk Assessment (Audit 2 of Internal Control) is also exactly what the evaluation of Internal Control over Financial Reporting (Audit 1 of Internal Control, for SOX) is.

Reason II. By deductive reasoning, each of the two Audits of Internal Control implies the other one.

Part II. A) Audit 1 implies Audit 2.
Based on AU 319.04, "The auditor may assess control risk at the maximum level because he or she believes controls are unlikely to pertain to an assertion or are unlikely to be effective, or because evaluating the effectiveness of controls would be inefficient."

Based on AU 319.04, above, there are three instances when the auditor may assess risk at maximum:
1) "controls are unlikely to pertain to an assertion" This instance does not apply, because as shown in I. D), both Audits have the same scope, therefore the same assertions pertain to both.
2) "controls are unlikely to be effective"
3) "evaluating the effectiveness of controls would be inefficient." This instance no longer applies, since evaluating the effectiveness of controls is now required by law (the Sarbanes-Oxley Act of 2002).

Only instance 2) applies, which shows that when controls are unlikely to be effective, then control risk is at maximum (in other words, ineffective Audit 1 implies ineffective Audit 2), and when controls are effective, none of the instances applies to set control risk at maximum, so it must be set at below maximum (so effective Audit 1 implies effective Audit 2).

Part II. B) Audit 2 implies Audit 1.
According to AU 319.70, "Assessing control risk below the maximum level involves:

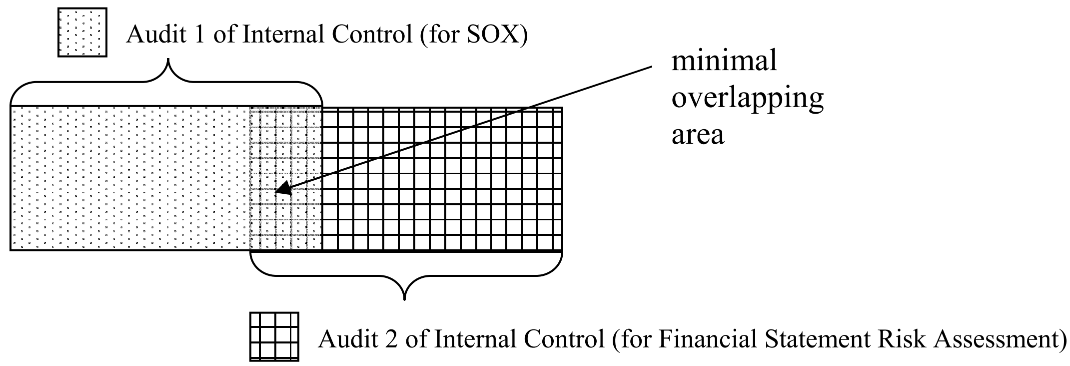
- -identifying specific controls relevant to specific assertions (in the Proposed Standard, this is in paragraphs 16-46)
- -performing tests of controls (in Proposed Standard paragraphs 47-69)
- -concluding on the assessed level of control risk (in Proposed Standard paragraphs 70-79)

By performing this work for Audit 2, the auditor would have also performed at the same time the work described in the corresponding paragraphs in the Proposed Standard related to Audit 1, in other words, Audit 2 implies Audit 1.

Based on both **Part II. A) and II. B)** above,
Audit 1 implies Audit 2 and
<u>**Audit 2 implies Audit 1**</u>
Based on both, it results that Audit 1 = Audit 2

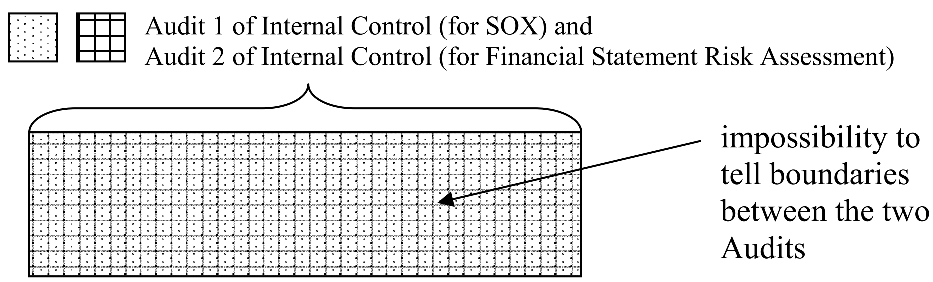
Reason III. Differentiation between two Audits of Internal Control is a loophole that can be used, and is already used, to nullify the benefits of the Proposed Standard.
I hope the Board considers the fact that it will be a hard battle for companies' management to decrease the amount of their work based on the Proposed Standard, because of the various interest groups such as internal or external auditors, who may want to perform more work than needed in order to maintain their overstaffed departments, their influence in the company, or their high fees.
Differentiation between two Audits will allow these groups to keep total work levels the same, but just re-partition them. The amount of work performed that cannot be attributed to Audit 1 of Internal Control, will still be performed, but attributed to Audit 2 of Internal Control. A graphical representation of this is as follows:

Misuse of Proposed Standard:

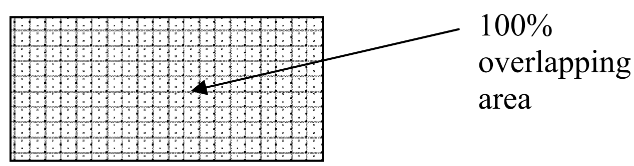


In practice, as auditors are instructed to integrate the two Audits, the two are blended together in such a way that it is hard to separate which controls they are auditing for which Audit, resulting in a integrated Audit that is much larger than what the Proposed Standard intends. This is already happening in industry in planning 2007 audits. A graphical representation of this is as follows:

Misuse of Proposed Standard: (with integrated Audits):



Compared to the Audit size of the Proposed view:



<u>Conclusion</u>

The two Audits of Internal Control are, in fact and in practice, one and the same Audit of Internal Control, based on sameness of methodology, underlying base, materiality threshold, scope, by definition and by deductive reasoning. Considering this, and to prevent misuse of the Proposed Standard, I hope that the Board will indicate in the final Standard that the two Audits of Internal Control are one and the same Audit of Internal Control, which can and should be used for two purposes: to form an opinion on Internal Control over Financial Reporting and to support the auditor's Assessment of Control Risk as well. <u>In the case of an effective Internal Control over Financial Reporting, no additional work is necessary to be performed to Assess Control Risk at lower than the maximum.</u>

Sincerely yours,

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