To: SEC Commissioners
Re: File no. PCAOB-2007-02
From: Monica Radu
Date: July 12, 2007

Dear SEC Commissioners,

Thank you for the opportunity to comment on SEC File no. PCAOB 2007-02 regarding the proposed Auditing Standard No. 5 (AS5), it is greatly appreciated.

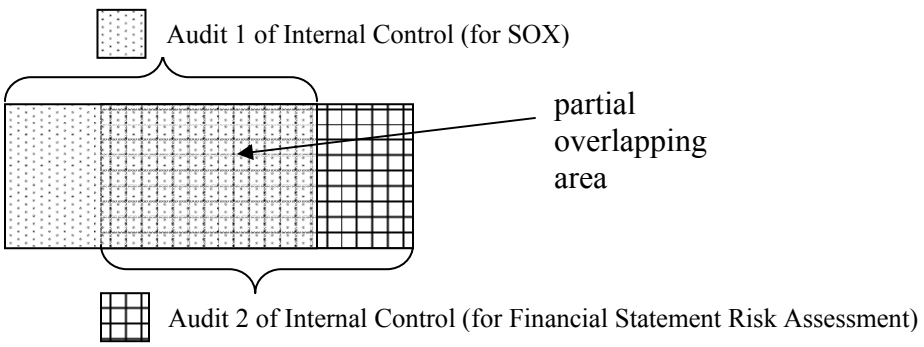
Scope of Comment
I would like to comment on AS5 appendix B paragraphs B1-B9, "Integration of Audits", which is describing the interrelationship of two Audits of Internal Control namely:
Audit 1: an Audit of Internal Control over Financial Reporting (for Sarbanes-Oxley) and
Audit 2: an Audit of Internal Control for Internal Control Risk Assessment (for Financial Statement Audit).

Thesis
I would like to propose that the distinction between the two Audits is only in the timing and format of the opinion/conclusion, and the purpose for which they are used (SOX or Financial Statement Audit), but there is no distinction in the work performed. Therefore, they are in fact one and the same Audit of Internal Control, and by performing the work described in AS5, both Audits would have been performed.

Background
AS5 is making a distinction between two Audits of Internal Control:
Audit 1: an Audit of Internal Control over Financial Reporting (for SOX) and
Audit 2: an Audit of Internal Control for Control Risk Assessment (for Financial Statement Audit).

This distinction can be seen in paragraphs such as B2: "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 B3: "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 current view of the two Audits of Internal Control can be graphically represented as follows (with some overlap but also some differences):

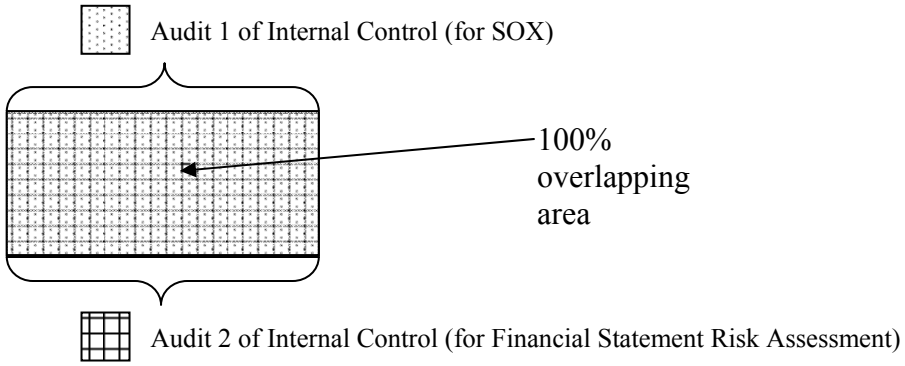
Current view:



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 - IV below. A graphical representation of the proposed view is as follows:

Proposed view:



Reason I. The two differences identified in AS5 paragraphs B1-B9 are in timing and format of the opinion/conclusion, not in the work performed.

Part I. A) Difference in timing of opinion/conclusion. The main difference that AS5 is identifying between the two Audits is in the timing of the opinion/conclusion (opinion for Audit 1, conclusion(s) for Audit 2):
Audit 1 (for SOX): is as of a point in time (original underline in AS5)
Audit 2 (for Financial Statement Audit): is for the entire period (original underline in AS5)

However, the difference in timing of the opinion/conclusion does not result in a difference in the work performed (neither the timing nor the scope of the work performed), as shown below:

> **The timing of the work performed,** in practice, is throughout the year for both Audits of Internal Control. The results of the work performed are extrapolated to a point in time (year-end) for Audit 1, and to the entire period, for Audit 2. The auditor can use the same knowledge gained throughout the year to assess the effectiveness of Internal Control as of a point in time as well as for the entire period (the same knowledge/work is used, though the opinion/conclusion on the effectiveness of controls for the two different time periods can be different). Roll-forward procedures can also be performed for both time periods.
>
> **The scope of the work performed** should not be affected by the timing of the opinion/conclusion, as timing and scope are two variables that are independent of each other. Therefore, AS5 should eliminate the differences in scope (additional controls) noted in paragraph B2 as being created by differences in timing. (In addition, as demonstrated in Reason II. D), the scope of the two Audits is the same).

Part I. B) Difference in format of opinion/conclusion. Another difference that AS5 is identifying between the two Audits is in the format of the opinion/conclusion:
Audit 1 (for SOX): is taken as a whole (original underline in AS5)

Audit 2 (for Financial Statement Audit): may be for less than all assertions (can be by individual assertion) (original underline in AS5)

However, in this case as well, the difference in format of the opinion/conclusion does not result in a difference in the work performed.

> **The work performed** is the same, because, as detailed in Reason II. D), the assertions relevant for both Audits are the same. The auditor performs work on all relevant assertions in order to form an opinion on Internal Control taken as a whole, and can use the same work to determine the assessed level of risk for each individual assertion.

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

A) the same methodology (AS5 and SAS 55, SAS 78, and AU 319)

The methodology described in AS5 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 AS5 paragraph 20: "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 III. By deductive reasoning, each of the two Audits of Internal Control implies the other one, therefore they are the same.

Part III. 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 situations when the auditor may assess risk at maximum:

-"controls are unlikely to pertain to an assertion" – this situation no longer applies, because as shown in Reason II. D), both Audits have the same relevant assertions.
-"evaluating the effectiveness of controls would be inefficient." - this situation no longer applies, since evaluating the effectiveness of controls is now required by the Sarbanes-Oxley law.
-"controls are unlikely to be effective", so there is an ineffective Audit 1, which implies an ineffective Audit 2. When controls are effective, control risk must be set at below maximum, so an effective Audit 1 implies an effective Audit 2.

Part III. 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" (similar to AS5 paragraphs 39-41)
-"performing tests of controls" (AS5 paragraphs 42-56)
-"concluding on the assessed level of control risk" (AS5 paragraphs 62-70)

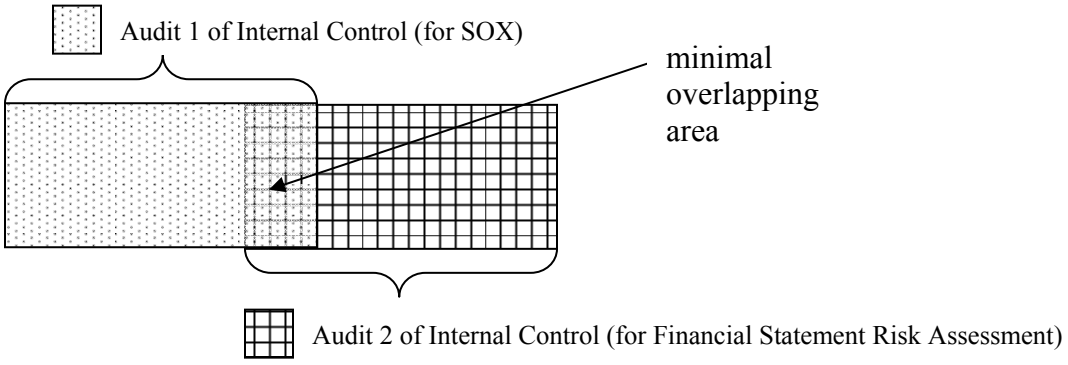
By performing this work for Audit 2, the auditor would have also performed at the same time the work described in the corresponding paragraphs in AS5 related to Audit 1, in other words, Audit 2 implies Audit 1.

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

Reason IV. Differentiation between two Audits of Internal Control creates bigger audits.

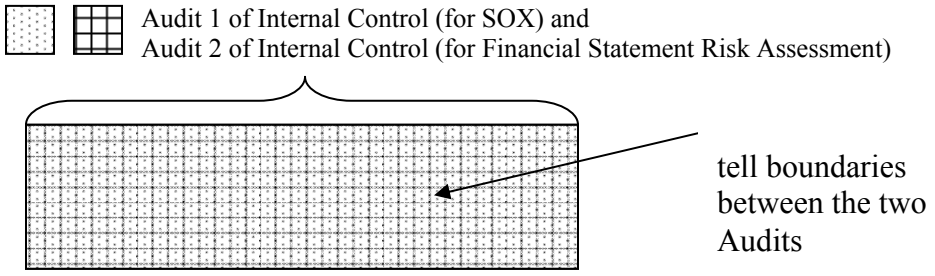
In past years, differentiation between Audit 1 and Audit 2 of Internal Control had the unintended consequence of creating bigger audits, as work for each Audit was performed separately, had a different scope, and the results were not used to support the purposes of both Audits. A graphical representation of this is as follows:

Differentiation between two Audits:

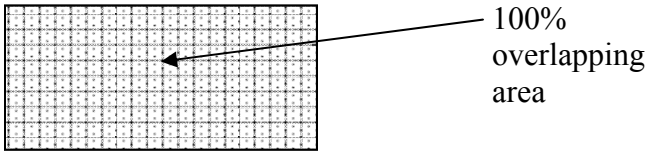


Integration of the two Audits per AS5 will help perform work for the two Audits together, but maintaining the difference between the Audits will allow the possibility of different scope of the work. The result could be work at continued high levels, but blended together in such a way that it is hard to identify which controls are audited for which Audit. The resulting integrated audit can remain bigger than intended. A graphical representation of this is as follows:

Differentiation between two Audits (with integrated Audits):



Compared to the audit size of the Proposed view:



Conclusion

The two Audits of Internal Control are, in fact and in practice, one and the same Audit of Internal Control, based on sameness of timing of work performed, methodology, underlying base, materiality threshold, scope, by definition and by deductive reasoning.

Implication

Considering the sameness of the Audits, and to prevent a bigger audit, I hope that AS5 Appendix B paragraphs B1-B9 will be revised to indicate that the two Audits of Internal Control are one and the same Audit of Internal Control. The Audit of Internal Control for Sarbanes-Oxley, which is required by law, performed according to the guidance in AS5 (with revised Appendix B), can and should be used to satisfy both timings and formats of the opinion/conclusion, and both purposes (SOX and Financial Statement Audit).

Sincerely yours,

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