July 12, 2007

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

Re: File Number PCAOB-2007-02

Dear Ms. Morris:

The following comments are in response to the Notice of Additional Solicitation of Comments on the Filing of Proposed Rule on Auditing Standard No. 5, published in June 2007.

My comments are based on recent efforts to coordinate with a large audit firm the implementation of AS 5 and the SEC guidance for management's assessment of internal control over financial reporting. I am a former partner in a "Big Four" firm, and currently head of Internal Audit of an issuer which has been subject to compliance with Section 404 since 2004. In addition, I served as a Board Member and an Audit Committee Financial Expert of a public company from 2003 to 2005. The comments herein reflect my own personal views.

Question (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?

Response: The communication requirement regarding significant deficiencies should not divert auditors' attention away from material weaknesses and should be retained in its present form. The audit committee, in carrying out its oversight responsibility, should be provided with all information that bears on management's attention to deficiencies or significant deficiencies in internal control over financial reporting. By having access to such information directly from the auditors, the audit committee can consider any corrective action plan by management or, alternatively, be in a position to be aware of a decision by management that remediation of a control deficiency was not necessary. The communication requirement in Paragraph 80 is very important.

<u>Question (5)</u> Is AS 5 sufficiently clear about the extent to which auditors can use the work of others?

<u>Response</u>: AS 5 is sufficiently clear with respect to the use of the work of internal auditors. However, AS 5 is not sufficiently clear regarding the circumstances in which the auditor may use the work performed by, or receive direct assistance from, company personnel in addition to internal auditors. While AS 5 refers to guidance in Paragraphs .09 through .11 of AU Sec. 322 and the principles underlying those paragraphs for assessing the competence and objectivity of persons other than internal auditors for purposes of using the work of such persons, how such guidance should be applied in practice is not sufficiently clear to allow auditing firms to use the work of company personnel other than internal auditors. For example, AU Sec. 322, Paragraph 10 indicates that the objectivity of an internal auditor would not be maintained if the auditor performs audit procedures in an area where the auditor was recently assigned or is scheduled to be assigned. This principle is readily understandable. The corollary principle would be that an internal auditor's objectivity is not impaired by performing auditing procedures in an area where the auditor has not been assigned and is not scheduled to be assigned though the internal auditor may have at some point in the past have been assigned or may in the future be assigned to a different area. This corollary principle should apply to company personnel in addition to internal auditors. For example, a parent company employee with an appropriate level of competence should be able to perform a walk-through under the principles of AU Sec. 322 for a functional area of a subsidiary where the parent company employee has never worked, is not scheduled to work and which functional area reports to a supervisor different than the parent company employee's supervisor. As a specific example, the parent company employee should be able to perform a walk-through of the payroll function of a subsidiary that reports to a supervisor employed by the subsidiary who does not report to the parent company employee or the parent company employee's supervisor. Unrelated duties of the parent company employee, such as assembling financial statements and related disclosures, should not impair the ability of an auditor to rely on the walk-through so long as the parent company employee has no involvement or authority with respect to the payroll function, including amounts reflected in the financial statements. I am aware that at least one auditing firm has provided informal advice to a client that any walk-through related work of a parent company employee in such a circumstance could likely not be used by the audit firm, despite the language in AS 5 and AU Sec. 322, because of the involvement of the parent company employee in preparing the quarterly financial statements and disclosures in Form 10-Q. That firm has generally indicated that the only circumstance where the work of employees other than internal auditors could be utilized would be in a circumstance where the employees had no responsibilities that extended beyond typical internal auditing functions.

Therefore, AS 5 needs further clarification with respect to the use of the work of others, possibly in the form of questions and answers with examples of when the work of others may or may not be used.

Question (6) Will AS 5 reduce expected audit costs under Section 404, particularly for smaller public companies, to result in cost-effective, integrated audits?

Response: For some public companies, AS 5 may reduce audit costs under Section 404 by a very nominal amount in the first year. However, in the longer term, audit costs under Section 404 will continue to be very high.

Specifically, I am aware of one issuer whose auditor stated that the elimination of the requirement for the audit firm to attest to management's opinion on internal control over financial reporting would result in no quantifiable reduction in audit hours.

For smaller public companies, the provisions of AS 5 which relate to internal control audits of multi-location entities should result in lower audit costs, particularly for smaller public companies that have thus far been eligible under SEC rules to defer full implementation of Section 404. However, while the audit costs for such companies will be lower than under AS 2, they will nevertheless likely be extremely high; in some cases, significantly greater than the cost of the current financial statement audit. This comment is based on experience observed at a multi-location company which sought to implement Section 404 prior to deferral of the effective date.

Question (7) Does AS 5 inappropriately discourage or restrict auditors from scaling audits, particularly for smaller public companies?

Response: While AS 5 taken alone does not inappropriately discourage or restrict auditors from scaling audits for smaller public companies, the combination of AS 5, the concerns of auditing firms regarding PCAOB inspections, the current interpretation of the concept of materiality in financial statements and other factors combine to discourage auditors from scaling audits. Some of these other factors were described in a speech on March 22, 2007, by Zoe-Vonna Palmrose, Deputy Chief Accountant, Office of the Chief Accountant of the SEC.

Ms. Palmrose's published speech included the following comments.

> **"Now, to transition from 404 to other issues to moving forward with SOX, I would like to say a bit more about PCAOB inspections. We are also hearing worries from various commenters that the PCAOB's inspection process will likely continue to contribute to an overly conservative implementation under any proposed auditing standard. For example, one worry related to 404 is that an overly prescriptive standard can result in a PCAOB inspection process that promotes inefficiency by focusing on technical compliance with prescribed requirements rather than on achievement of overall audit objectives. Generally, the concern is that unnecessary audit work will continue, irrespective of any revised guidance, and that the auditing standard will continue to drive management's evaluation process because of the PCAOB's inspection process."**

Based on the information I have read and heard others describe, to this point in the implementation of AS 5, the "worries" of the commenters alluded by Ms. Palmrose remain as significant factors in how audit firms approach the audit of internal control over financial reporting. It is doubtful that AS 5 will change this particular factor.

I appreciate the opportunity given by the SEC to submit comments on these important questions.

Very truly yours,

J. Lavon Morton, CPA