

MEMO# 20889

February 21, 2007

ICI Draft Comment Letter on PCAOB Proposal on Audits of Internal Control Over Financial Reporting

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TO: ACCOUNTING/TREASURERS COMMITTEE No. 3-07
SEC RULES COMMITTEE No. 16-07 RE: ICI DRAFT COMMENT LETTER ON PCAOB
PROPOSAL ON AUDITS OF INTERNAL CONTROL OVER FINANCIAL REPORTING

The Public Company Accounting Oversight Board recently released a proposed audit standard, An Audit of Internal Control Over Financial Reporting That is Integrated with An Audit of Financial Statements. [\[1\]](#) The proposed audit standard would supersede PCAOB Audit Standard No. 2 ("AS No. 2"), which was adopted in 2004 to implement audits of internal control over financial reporting as mandated by Section 404 of the Sarbanes-Oxley Act of 2002. The proposed new standard is a principles-based standard designed to focus the auditor on the most important matters in an audit of internal control over financial reporting.

As you know, investment companies registered under Section 8 of the Investment Company Act are not subject to audits of internal control over financial reporting mandated by Section 404. However, the proposed audit standard revises the AS No. 2 definition of material weakness and delineates the circumstances that are strong indicators that a material weakness in internal control over financial reporting exists. The Institute's draft comment letter is attached and briefly summarized below.

Members with comments on the Institute's draft letter should provide them to the

undersigned by phone (202-326-5851) or email (smith@ici.org) no later than Friday, February 23rd.

The Institute's letter expresses concern that, in practice, any restatement of previously issued financial statements is deemed to be a material weakness in internal control over financial reporting, notwithstanding extenuating circumstances that should enable the auditor to conclude no material weakness exists. The letter urges the PCAOB to more strongly state that the presence of one of the strong indicators does not require the auditor to reach a conclusion that a material weakness exists.

Further, the Institute's letter recommends that the final standard exclude from the strong indicators a restatement due to a change in the application of an accounting principle. In particular, where an issuer is required to restate previously issued financial statements as a result of a change in the application of an accounting principle, the issuer should not be deemed to have a material weakness in internal control, so long as: i) the issuer's controls over the selection and application of accounting policies in the period to be restated provided reasonable assurance regarding the reliability of its financial reporting; and ii) the auditor opined that the prior period's financial statements were prepared in conformity with generally accepted accounting principles.

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[Attachment](#)

endnotes

[1] PCAOB Release No. 2006-007 (December 19, 2006). The proposed audit standard is available from the PCAOB website <http://www.pcaobus.org/Standards/index.aspx>.

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