I. Introduction

On July 28, 2005, the Public Company Accounting Oversight Board (the “Board” or the “PCAOB”) filed with the Securities and Exchange Commission (“Commission”) proposed Auditing Standard No. 4, Reporting on Whether a Previously Reported Material Weakness Continues to Exist, pursuant to the Sarbanes-Oxley Act of 2002 (the “Act”) and Section 19(b) of the Securities Exchange Act of 1934 (the “Exchange Act”).

Auditing Standard No. 4 establishes requirements that apply when an auditor is engaged to report on whether a previously reported material weakness in internal control over financial reporting continues to exist. Also, in connection with proposed Auditing Standard No. 4, the Board adopted a proposed conforming amendment to AT sec. 101, which encompasses agreed-upon procedures engagements in which an auditor reports findings based on specific procedures performed on a subject matter. AT sec. 101, Attest Engagements, is one of the interim attestation standards adopted by the PCAOB in April 2003.

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1. 15 U.S.C. 7202 et seq.
3. A previously reported material weakness, in the context of the proposed auditing standard, means a material weakness that was described previously in an auditor’s report issued pursuant to PCAOB Auditing Standard No. 2, An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements.
Notice of proposed Auditing Standard No. 4 and proposed amendment to AT sec. 101 (collectively referred to as the “Proposed Standard”) was published in the Federal Register on December 30, 2005, and the Commission received six comment letters. For the reasons discussed below, the Commission is granting approval of the Proposed Standard.

II. Description

The Act establishes the PCAOB to oversee the audits of public companies and related matters, to protect investors, and to further the public interest in the preparation of informative, accurate and independent audit reports. Section 103(a) of the Act directs the PCAOB to establish auditing and related attestation standards, quality control standards, and ethics standards to be used by registered public accounting firms in the preparation and issuance of audit reports as required by the Act or the rules of the Commission.

The Proposed Standard is applicable to engagements tailored solely to report on whether a previously reported material weakness continues to exist. Such an engagement is voluntary in nature at the election of management, and may be performed as of any reasonable date selected by management. The auditor may report on the remediation of one or more material weaknesses as part of a single engagement, and the engagement need not be performed in conjunction with an audit or review of the company’s financial statements. In order to perform such an engagement, the auditor must receive a written report from management that contains several elements, including a statement from

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5 Release No. 34-52990 (December 21, 2005) [70 FR 77602].
6 Section 101(a) of the Act.
management that the identified material weakness no longer exists as of the date specified by management. If the auditor determines that the material weakness continues to exist, the company may re-address remediation efforts and re-engage the auditor to opine on whether the material weakness continues to exist. The Proposed Standard also includes illustrative auditor’s reports (Appendix A) and additional guidance (Appendix B –“Background and Basis for Conclusions”).

The Proposed Standard states that, if approved by the Commission, it would be effective as of the date of Commission approval.

III. Discussion

The Commission’s comment period on the Proposed Standard ended on January 20, 2006, and the Commission received six comment letters. The comment letters came from four registered public accounting firms and two professional associations.

None of the comment letters received were from issuers or investors. In general, the respondents expressed support for the Proposed Standard.

As part of their comment letters, two accounting firms and a professional organization representing the internal audit profession requested guidance on questions regarding the acceptable forms for use in filing management’s report and the auditor’s report. In response to these questions, the following is noted:

• Since the Commission’s rules do not specifically address the filing of such voluntary information, if an issuer wishes to publicly disseminate the reports of management and the auditor on whether a previously reported material weakness continues to exist, an issuer can use any Exchange Act form it believes is appropriate.
• Our rules do not specify the form of disclosure that management should use when describing the circumstances surrounding the remediation of a previously reported material weakness, and our general disclosure principle and requirements would apply. However, the disclosure should not amend management’s conclusion on the effectiveness of internal control over financial reporting as of the end of the fiscal year (performed pursuant to the Commission’s rules implementing Section 404 of the Sarbanes Oxley Act of 2002). Further, management can only conclude that internal control over financial reporting is effective if as of the time of remediation of a material weakness (or as of any other time) an assessment of effectiveness pursuant to those rules is performed as of that time.

• If the remediation was completed between the end of the fiscal year and the filing of the Form 10-K, management may include a single, combined report on the results of the annual assessment of internal control over financial reporting and the subsequent conclusion related to the remediation of a material weakness identified in the annual assessment.

IV. Conclusion

The Commission believes that the proposed rules provide a reasonable format for assessing whether a material weakness in a company’s internal controls that has been, or is being, reported to investors continues to exist. However, to facilitate implementation of the standard, the Commission expects the PCAOB, within 90 days of the issuance of this order, to issue a clear and concise outline of the affirmative audit steps set forth in the standard.

On the basis of the foregoing, the Commission finds that proposed Auditing Standard No. 4 and the proposed amendment to AT sec. 101 are consistent with the requirements of the Act and the securities laws and are necessary and appropriate in the public interest and for the protection of investors.

IT IS THEREFORE ORDERED, pursuant to Section 107 of the Act and Section 19(b)(2) of the Exchange Act, that proposed Auditing Standard No. 4, Reporting on Whether a Previously Reported Material Weakness Continues to Exist and a proposed Conforming Amendment to Interim Attestation Standard – AT sec. 101, Attest Engagements (File No. PCAOB-2005-01) be and hereby is approved.

By the Commission.

Nancy M. Morris
Secretary