

Mr. Jonathan G. Katz  
Secretary  
United States Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549-0609

May 17, 2004

**Comments on PCAOB Rulemaking:  
Notice of Filing of Proposed Rule on Auditing Standard No. 2, An Audit of Internal  
Control Over Financial Reporting Performed in Conjunction with an Audit of  
Financial Statements  
[Release No. 34-49544; File No. PCAOB-2004-03]**

Dear Mr. Katz:

Siemens Aktiengesellschaft appreciates the opportunity to comment on the Public Company Accounting Oversight Board's ("PCAOB" or "Board") Auditing Standard No. 2 (the "Standard"), *An Audit of Internal Control over Financial Reporting Performed in Conjunction with An Audit of Financial Statements*.

We are a stock corporation organized in the Federal Republic of Germany and employed an average of 419,300 people in approximately 190 countries worldwide during fiscal 2003. We have a balanced business portfolio in information and communications, automation and control, power, transportation, medical, lighting and financing and real estate.

We strongly support the PCAOB's intent to further strengthen investor protection and to re-establish and foster investor confidence in a corporation's financial reporting and disclosures. Providing reliable and trustworthy information to investors and in general, fulfilling its duties towards investors represent key responsibilities of companies and companies' management. While we believe, PCAOB's Auditing Standard No. 2 enhances its preceding interim standards and Proposed Auditing Standard by providing additional guidance and clarification, we respectfully request the Securities and Exchange Commission ("SEC") to further modify PCAOB's Auditing Standard No. 2 upon consideration of the comments included in this letter.

**(1) Inadequate documentation**

The Standard provides that inadequate documentation of the design of controls over relevant assertions related to significant accounts and disclosures represents a deficiency in internal control over financial reporting. To conclude on whether a deficiency represents a significant deficiency or a material weakness is left to the professional judgment of the auditor.

In our opinion, while we agree that inadequate documentation of internal controls is a deficiency, inadequate documentation does not necessarily represent a material weakness or a significant deficiency. Instead, solely a lack of adequate documentation of

controls shall not result in it being classified as a significant deficiency or a material weakness provided the internal controls are designed properly, are placed in operation and are operating effectively. A requirement to classify a properly functioning internal control as a significant deficiency or a material weakness merely based on the grounds of lacking adequate documentation is a too excessive and simply inconceivable. Such a provision will result in unnecessary and not justifiable bureaucracy. Implementation and maintenance will be overly burdensome to companies. We believe, in order to prevent inefficiencies and increases in costs far outweighing its benefits, it is important to streamline processes and keep the extent of documentation still at an appropriate and adequate yet not bureaucratic level. Accordingly, we ask the SEC to reconsider the PCAOB's view and modify the current Standard accordingly. This will prevent companies from implementing and maintaining overly detailed or duplicate documentation by simply trying to be precautious.

## **(2) Using the work of others and walkthroughs**

We appreciate the Board's conclusion to facilitate using the work of others.

We support PCAOB's less restrictive approach to permit auditors to exercise due professional judgment in using the work of competent and objective internal auditors and others under the circumstances stipulated by the PCAOB. However, the PCAOB still restricts the auditor from using the work of others with respect to testing the control environment and with respect to performing walkthroughs for major classes of transactions. The auditor is required to perform the tests on his/her own in order to comply with the definition of 'principal evidence' as defined by the PCAOB. Since the auditor exercises due professional care in assessing competency, objectivity and independence of personnel performing the work considered to be used as well as the quality of the resulting work, and provided the auditor concludes that the results of the work performed by others is acceptable and meets the necessary requirements, the auditor shall be able to conclude on his/her own to which extent the work can be used and to which extent additional work may be necessary or whether other testing procedures will lead to the most efficient and sufficient evidence (e.g. fully or partially use of walkthroughs performed by others in conjunction with inquiries of Company personnel, inspection or observations). We believe, this approach is by no means contradictory to obtaining independent 'principal evidence'. On the contrary, we believe, since the scope of testing and the professional judgment on whether the work of others can be used (requiring a conclusion about whether the work of others meets the auditor's purpose and about whether the work performed is in accordance with promulgated requirements) still rests with the external auditor this approach represents independently generated principal evidence. We therefore ask the SEC to reconsider modifying PCAOB's Standard accordingly.

## **(3) Definition of Significant Deficiency / Material Weakness**

The final standard retained the substance and the original structure of the key definitions 'significant deficiency' and 'material weakness'. We appreciate the PCAOB's efforts to further clarify those key definitions.

We understand that a precise definition in this subject matter is challenging to reach. We also understand that a broader definition provides various significant advantages over more restrictive definitions and thus further guidance may have been omitted intentionally. However, we believe that issuers and investors would greatly benefit from an explicit promulgation stipulating that internal control deficiencies do neither constitute a significant deficiency nor a material weakness provided compensating controls over the processes exist that mitigate or diminish the risk (e.g. at another level such as within the reporting group or at the parent level).

#### **(4) Acquisitions close to year-end**

We recommend the SEC or PCAOB provide additional guidance on required issuer assessment of an acquired company's internal control over financial reporting, including circumstances giving rise to appropriate limitations of the scope of an issuer's overall assessment. For example, certain acquisitions closing near an issuer's fiscal year end may not permit a timely inclusion of the acquired company's internal controls in an issuer's overall assessment – especially if the acquired company was not subject to the respective SEC/PCAOB regulations. Guidance on this issue is critical (e.g. is it sufficient for material acquisitions if a company discloses its recent acquisition, reports on the company's assessment about whether the company concluded on the effectiveness of the acquired company's internal controls over financial reporting, its conclusion reached as well as the method used in reaching this conclusion?).

#### **(5) Cost benefit considerations**

Testing internal controls has always been part of audits carried out in accordance with professional standards. In accordance with a risk based approach, an auditors' conclusion reached on internal control testwork has always been impacting the extent of subsequent substantive testwork. Effectively operating internal controls can reduce the amount of substantive testwork necessary to reach a final conclusion on the company's fairly presented financial statements in every material respect. Accordingly, we strongly appreciate the Board's efforts and intent to closely oversee and monitor overly excessive increases in audit fees charged to corporations on the grounds of increasing internal control testwork.

We believe, it is important to still see the broad picture: while we strongly agree that effectively operating internal controls are absolutely essential for a successfully operating corporation the mere documentation of internal controls does not by its own result in an immediate or direct improvement. The documentation merely supports the conclusiveness over the controls operating effectiveness and its sufficiency. Overly excessive documentation and overly extensive testwork of auditors resulting in bureaucracy and additional costs is neither beneficial to the corporation nor to its investors. A proper balance between an appropriate level of documentation and its effectiveness and efficiency, preventing overly burdensome bureaucracy, needs to be found and maintained.

Finally, we would like to point out that foreign private issuers are facing substantial costs in complying with U.S. listing and registration requirements, such as costs to maintain two different sets of accounting standards, increasing audit fees, additional fees with

respect to director's and officer's insurance, and escalating legal fees to prepare documents to be filed with the SEC. We ask that you please be mindful that significant additional costs and other burdens offering negligible investor benefits increasingly strain foreign private issuers' determinations that the advantages of a foreign company's secondary listing in the U.S. are justified by the increasingly mounting overall burdens.

If you have any questions please contact Dr. Georg Klein (e-mail: [georg.klein@siemens.de](mailto:georg.klein@siemens.de)) at +49 89 636 33393.

Sincerely yours,

Siemens Aktiengesellschaft

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