



January 26, 2006

PCAOB Proposes Auditing Standard on Reporting Whether a Previously Reported Material Weakness Continues to Exist

The SEC has issued a release (Release No. 34-52990) to solicit comment on the PCAOB's proposed auditing standard governing the engagement of an auditor to report on whether a previously reported material weakness continues to exist. The proposed standard addresses the desire of registrants to obtain an opinion on the status of a material weakness as of an interim date instead of having to wait until the year-end audit of its financial statements and internal control over financial reporting.

Under the proposed standard, in order for an auditor to be able to issue a report on whether a material weakness has been corrected, management would be required to present a written report that:

- states that management is responsible for establishing and maintaining effective internal control over financial reporting for the company;
- identifies the control criteria management uses when it conducts its annual assessment of the effectiveness of the company's internal control over financial reporting;
- identifies the material weakness;
- identifies the control objectives addressed by the specified controls and states that the specified controls achieve the stated control objectives as of a specified date; and
- states that the identified material weakness no longer exists as of the same specified date because the specified controls address the material weakness.

Under the proposed standard, the scope of an auditor's engagement would be limited to testing the controls specifically identified by management as eliminating the material weakness. If the auditor finds a new material weakness in the course of its engagement or determines that the material weakness continues to exist despite management's assertion to the contrary, the auditor may elect not to issue a report. In such situations, the auditor is

1285 Avenue of the Americas
New York, New York 10019-6064
(212) 373-3000

1615 L Street, NW
Washington, DC 20036-5694
(202) 223-7300

Alder Castle, 10 Noble Street
London EC2V 7JU England
(44-20) 7367 1600

Fukoku Seimei Building 2nd Floor
2-2, Uchisawaicho 2-chome
Chiyoda-ku, Tokyo 100, Japan
(81-3) 3597-8120

Unit 3601, Fortune Plaza Office Tower A
No. 7 Dong Sanhuan Zhonglu
Chao Yang District, Beijing 100020
People's Republic of China
(86-10) 5828-6300

12th Fl., Hong Kong Club Building
3A Chater Road, Central
Hong Kong
(852) 2536-9933

required to communicate to the audit committee in writing the auditor's conclusion. If the auditor determines that additional remediation is needed, the company may undertake the remediation, re-set the date as of which management asserts that the material weakness no longer exists and ask the auditor to evaluate whether the material weakness continues to exist as of the new assertion date.

The proposed standard allows an engagement to be undertaken at any time during the year, while recognizing that, depending on the nature of the material weakness, the date of management's assertion may need to be after the completion of one or more interim periods.

Auditor reports under the proposed standards would be limited to addressing material weaknesses previously identified in an auditor's report on internal control over financial reporting as of year-end. A material weakness that is initially identified in an interim report cannot be addressed under the proposed standard until after it has been reported in an annual report.

Engagements under the proposed standard would be entirely voluntary and the PCAOB believes that companies will choose to engage an auditor under the proposed standard only when the benefits outweigh the costs, such as when the material weaknesses are discrete problems. In cases where a material weakness has a pervasive impact on the company's internal control over financial reporting, such as a material weakness that relates to an ineffective control environment, companies may elect to wait until the next year-end audit report.

* * * * *

Note that this memorandum addresses rules that are currently proposed by the SEC. The SEC solicited comments to the proposed rules and the comment period ended on January 20, 2006. After comments are received, the SEC staff prepares a final set of new rules (which may be modified from the proposed set of rules) for approval by the SEC Commissioners. Once approved, the effective date could be immediate or subject to a transition period.

This memorandum is not intended to provide legal advice with respect to any particular situation and no legal or business decision should be based solely on its content. Questions concerning issues addressed in this memorandum should be directed to any member of the Paul Weiss Securities Group, including:

Mark S. Bergman	(44 20) 7367-1601	Edwin S. Maynard	(212) 373-3034
Richard S. Borisoff	(212) 373-3153	Raphael M. Russo	(212) 373-3309
Andrew J. Foley	(212) 373-3078	Lawrence G. Wee	(212) 373-3052
John C. Kennedy	(212) 373-3025	Tong Yu	(81 3) 3597-6306

PAUL, WEISS, RIFKIND, WHARTON & GARRISON LLP