

April 23, 2004

Mr. J. Gordon Seymour
Acting Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, D.C. 20006-2803

PCAOB Rulemaking Docket Matter No. 014
Proposed Auditing Standard—Conforming Amendments to PCAOB Interim Standards Resulting From the Adoption of PCAOB Auditing Standard No. 2, An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements

Dear Mr. Seymour:

We are pleased to comment on the PCAOB's proposed auditing standard related to conforming amendments to PCAOB interim standards. Overall, we support the proposed auditing standard because we believe it clarifies the changes that are being made to interim standards resulting from the adoption of PCAOB Auditing Standard No. 2, and knowledge of such changes is very important to practitioners in performing audits for which Section 404 is not applicable and only the financial statements of an entity must be audited.

We have organized our comment letter to respond to the questions on which the Board seeks public comment and then to provide one additional comment regarding the effective date.

1. Are the references useful in assisting auditors when performing an integrated audit of financial statements and internal control over financial reporting?

Yes. We believe the references in specific paragraphs of interim standards will be useful to auditors in determining those provisions of interim standards that are changed or affected by PCAOB No. 2.

2. Have any references been omitted from the proposed auditing standard that commenters believe would be beneficial?

No. We believe the references identified are sufficient and address the key areas of change.

3. Do the proposed amendments clearly describe the new requirements that apply when the auditor is engaged to audit only the financial statements?

Yes. We believe the amendments clearly describe the new requirements that apply when the auditor is engaged to audit only the financial statements, although we also have comments on some of those requirements as discussed in Question 4 below.

4. Are there any additional requirements that are applicable in an integrated audit of financial statements and internal control over financial reporting that also should be applicable when the auditor is engaged to audit only the financial statements? For example:

- Should the auditor be required to report all internal control deficiencies (i.e., including internal control deficiencies that are less severe than significant deficiencies and material weaknesses) to management not previously communicated in writing by the auditor or by others? (Under the proposed amendment, the auditor would be required to report to management and the audit committee significant deficiencies and material weaknesses identified during the audit.)
- Should the auditor be required to evaluate the effectiveness of the audit committee's oversight of the external financial reporting process and the internal control over financial reporting? (Under the proposed amendment, the auditor does not have an explicit requirement to make this evaluation but would be required to report in writing to the board of directors a conclusion that the audit committee's oversight is ineffective, even if the auditor did not perform an evaluation to reach that conclusion.)

When the auditor is engaged to audit only the financial statements, and not to perform an integrated audit, we believe it is appropriate for auditing standards to require the auditor to report only significant deficiencies and material weaknesses in writing, and to permit the audit committee or management to decide whether it wishes to have the auditor report other deficiencies in writing.

When the auditor is engaged to audit only the financial statements, and not to perform an integrated audit, we agree with the proposed amendment that the auditor should not be explicitly required to evaluate the effectiveness of the audit committee's oversight, but should be required to communicate in writing if the auditor reaches a conclusion that there is a significant deficiency or material weakness in the audit committee oversight. We further suggest that the wording in paragraph 5 of the proposed auditing standard to supersede SAS 60 be amended as follows (inserted words are underlined):

Although there is not an explicit requirement to evaluate the effectiveness of the audit committee's oversight of the external financial reporting process and the internal control over financial reporting, if the auditor becomes aware that a significant deficiency or material weakness exists because the oversight of the company's external financial reporting and internal control over financial reporting by the company's audit committee is ineffective, the auditor must communicate that specific significant deficiency or material weakness in writing to the board of directors.

5. Are there any circumstances in which the proposed amendments in an audit of financial statements are not appropriate or should not be made? If so, what are those circumstances, and why do they indicate that the proposed amendment is not appropriate?

No, except for the following editorial suggestion. We believe the last line to the amendment to SAS 92, "Auditing Derivative Instruments, Hedging Activities, and Investments in Securities," should be modified to indicate that there may be no, one, or multiple service organizations that may be part of the entity's information system as follows:

...and should encompass controls placed in operation by the entity and ~~the~~ any service organizations whose services are part of the entity's information system.

6. Are there any circumstances in which issuers would want or need to file an AT sec. 501 report with the Commission?

No. We are not aware of any circumstances in which an issuer would want or need to file an AT sec. 501 report as part of an integrated audit or quarterly review. However, we do believe there may be situations in which an issuer will want to engage an auditor to issue a report on aspects of internal control over financial reporting other than as part of an integrated audit (or quarterly review).

7. Should AT sec. 501 be amended rather than superseded?

No. We do not see any need for AT sec. 501 to remain part of the PCAOB interim standards.

8. Is there a need for an auditor's report on internal control in addition to the auditor's report on the integrated audit of financial statements and internal control over financial reporting?

As indicated above, we believe issuers may choose to have reports issued on internal control topics, but we do not believe such reports would be prepared as part of an integrated audit or quarterly review.

Additional Comment on Effective Date

The proposed effective date for these conforming amendments is "...for audits of financial statements and integrated audits of financial statements and internal control over financial reporting for periods ending on or after November 15, 2004. Early compliance with this standard is permitted." Audits for such periods have already commenced. We believe auditing standards should not be effective retroactively. Although the nature of this proposed auditing standard is such that we believe auditors would be able to apply it for audits of periods ending on or after November 15, 2004, we encourage the PCAOB in its standard-setting activities to adopt a practice in which the effective date for changes to auditing standards is prospective rather than retroactive.

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We would be pleased to discuss our comments with members of the Public Company Accounting Oversight Board or its staff.

Very truly yours,

Ernst + Young LLP