

May 12, 2003

Ronald S. Boster  
Acting Secretary  
Public Company Accounting Oversight Board  
1666 K Street NW  
Washington, D.C. 20006-2803

**PCAOB Rulemaking Docket Matter No. 004,  
Statement Regarding The Establishment Of Auditing And Other Professional Standards**

Dear Mr. Boster:

We are pleased to submit this comment letter to the Public Company Accounting Oversight Board (“PCAOB” or the “Board”) regarding the above-referenced PCAOB Rulemaking Docket Matter. Overall we support proposed PCAOB Rules 3100 and 3700.

Our views and significant comments on these proposed PCAOB Rules are set out in this letter.

**Definition of Professional Auditing Standards Applicable to Registered Public Accounting Firms**

Proposed PCAOB Rule 3100 states:

A registered public accounting firm and its associated persons shall comply with all applicable professional auditing standards.

It is our understanding that the Sarbanes-Oxley Act of 2002 (the “Act”) requires the PCAOB to establish professional auditing standards for an ‘audit’ of an ‘issuer’ as defined in the Act. The proposed PCAOB Rule could be misinterpreted to mean it would apply to all audits (issuers and non-issuers) performed by a registered public accounting firm, which we believe is inconsistent with the definitions of an “issuer” and an “audit” in Section 2(a) of the Act. We believe the following clarification will avoid any possible confusion regarding the PCAOB Rule applicability to audits performed by a registered public accounting firm of entities that are not issuers:

A registered public accounting firm and its associated persons shall comply with all applicable professional auditing standards in performing an audit of an issuer.

We also recommend that the related “note” be expanded to include the definition of “audit” and “issuer.”

Note: Under Section 102(a) of the Act, public accounting firms are not required to register with the Board until 180 days after the date of the determination of the Commission under section 101(d) that the Board has the capacity to carry out the requirements of Title 1 of the Act (the “mandatory registration date”). The Board intends that, during the period preceding the mandatory registration date, this rule would apply to public accounting firms that would be required to be registered after the mandatory registration date and to associated persons of those firms, as if those firms were registered public accounting firms. The term ‘audit’ means an examination of the financial statements of any issuer by an independent public accounting firm in accordance with the rules of the Board or the Commission, for the purpose of expressing an opinion on such statements. The term ‘issuer’ means an issuer (as defined in section 3 of the Securities and Exchange Act of 1934 (15 U.S.C. 78c)), the securities of which are registered under section 12 of that Act (15 U.S.C. 781), or that is required to file reports under section 15(d) (15 U.S.C. 78o(d)), or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 (15 U.S.C. 77a et seq.), and that it has not withdrawn.

#### **Review of Internal Controls and Section 404 Attestation Standard**

We believe it is important for the PCAOB to address the standards for reporting in connection with Section 404 of the Act. The PCAOB has indicated that the adoption of attestation standards for reporting on internal controls under Section 404 is one of three high-priority projects that the Board intends to commence as soon as possible. We strongly encourage the Board to give this project the highest priority, taking precedence over the review of Interim Professional Auditing Standards and the adoption of statutory professional auditing standards.

We agree with the PCAOB’s plan to review both the existing attestation standard (adopted by the PCAOB as part of its Interim Professional Auditing Standards) and the auditing and attestation exposure drafts recently published by the American Institute of Certified Public Accountants (“Exposure Drafts”). We believe the Exposure Drafts represent the best practices developed from a decade of applying the existing standard, which was not originally developed in anticipation of broad-based internal control reporting by all public companies. Upon reviewing both the existing standard and the Exposure Drafts, we believe the Board will find the Exposure Drafts to be an appropriate base from which to develop its standard(s). As soon as possible, the Board should commence its standard-setting process with respect to this topic, make whatever modifications the Board then deems appropriate and in the public interest, and proceed with issuing its proposed standards on internal control reporting.

### **Advisory Groups and Task Forces**

Proposed PCAOB Rule 3700 provides for the formation, composition and use of advisory groups in the PCAOB's standards-setting process. We agree with the formation of the advisory group and also believe it would be useful to form, at the Board's discretion, smaller ad hoc task forces to assist in developing or evaluating standards and to provide input to the Board or its staff.

However, we believe it would be helpful if some additional guidelines were included in the final rule regarding: 1) the term of advisory members (e.g., a one-year term and eligibility for re-appointment of three additional one-year terms); 2) whether or not advisory group meetings will be open to the public; and 3) the format (e.g., oral presentation of a summary of the written materials by the PCAOB staff, followed by discussion of each issue presented and questioning the points raised) and expected frequency of such meetings (e.g., at least quarterly).

Further, we believe the final PCAOB Rule 3700 should explicitly provide that the membership of the advisory group at all times should include representatives from the largest registered public accounting firms that audit the financial statements of a significant number of issuers. We support the PCAOB's proposal regarding the composition of the advisory board and we agree with the need for representation of all constituencies involved in the financial reporting process. However, we are concerned about placing specific limits on the representation of any single constituency. The public interest will best be served if the advisory group includes those persons in a position to become aware of emerging auditing issues as they arise, before issues become widespread and before divergent practices become entrenched.

### **Consideration of International Auditing Standards**

The environment for establishing professional auditing standards increasingly involves international audit issues. The International Auditing and Assurance Standards Board ("IAASB") is considering exposure drafts of very significant auditing standards, many of which were intended to converge with auditing standards in the United States and proposed changes thereto. The IAASB is also considering several other significant changes to International Auditing Standards for implementation by 2005.

We urge the PCAOB to consider the changes being made in International Auditing Standards as it conducts its review of existing United States standards and sets future standards, including cooperation and coordination with the IAASB prospectively on the development and convergence of high-quality standards.

### **Exposure Period**

As part of the due process procedures for the adoption of new or amended Professional Auditing Standards, the Board has proposed providing for a public comment period of 21 calendar days. The rule proposal also indicates that a comment period of less than 21 days may be appropriate under relevant circumstances.

Although we support prompt issuance of new or modified auditing standards with an objective of improving the quality of audits of public companies, we believe that a “normal” comment period of 21 calendar days will not be sufficient to appropriately analyze and comment on far-reaching new or modified standards. Such a period is shorter than the typical comment period for rulemaking by the Securities and Exchange Commission or the Financial Accounting Standards Board. We recommend that the PCAOB consider a standard public comment period of 30 to 60 days, or perhaps longer in certain circumstances. As the Board considers global convergence in the development of auditing standards, a longer comment period might be necessary or desirable to obtain appropriate input from global constituencies.

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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*