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VIA ELECTRONIC FILING

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

**PCAOB Rulemaking 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:

Ernst & Young LLP (“Ernst & Young”) is pleased to submit comments on the rule adopted by the Public Company Accounting Oversight Board (“PCAOB”) to establish an auditing standard regarding an audit of internal control performed in conjunction with an audit of financial statements.

**Overall Views on the Proposed Auditing Standard**

We recognize that this proposed standard is the result of an intensive effort on the part of the PCAOB and its staff to respond to the many comments received during the exposure draft process and to produce a standard that would result in high quality integrated audits. We commend the PCAOB and its staff for those efforts. The PCAOB and its staff were faced with a difficult challenge in balancing the benefits from the auditing and reporting by independent auditors on an issuer’s internal controls over financial reporting with the additional costs to

issuers that result from the additional work to be performed. Many interested parties commented and expressed a wide range of views, and the PCAOB and its staff seemed to carefully consider those views, and make necessary changes (particularly in providing more latitude for the use of competent and objective internal auditors) in arriving at a proposed final auditing standard that is grounded in improving the financial reporting that is so critical to the capital markets. While most interested parties (including our firm) would still suggest revisions or clarifications to certain provisions of the proposed standard, we believe it is an important first step in providing much needed guidance to auditors in performing and reporting on audits of internal control over financial reporting. We support the issuance of this rule as a final auditing standard.

#### **Need for Additional Implementation Guidance**

Although we support the issuance of this rule as a final auditing standard, we believe there remains a need for additional guidance on implementation issues. While some additional implementation guidance is necessary to assist auditors in the consistent execution of audits of internal control over financial reporting in accordance with the proposed auditing standard, additional implementation guidance is particularly necessary to assist SEC issuers in fulfilling their responsibilities in making their assessments of internal controls over financial reporting in accordance with the SEC's rules applicable to the implementation of Section 404 of The Sarbanes-Oxley Act of 2002 ("Section 404"). The PCAOB's proposed auditing standard is directed to auditors and not to issuers, and thus it can only provide incidental, indirect guidance to issuers. The SEC's rules for issuers in implementing the requirements of Section 404 were issued prior to the PCAOB's formulation of its proposed auditing standard. Given the responsibility placed on issuers for establishing, maintaining, evaluating, and reporting on

internal controls, additional guidance for them in fulfilling the requirements of the SEC's rules is warranted. Some of the key areas that we believe warrant additional guidance based on questions we have received from issuers include the scope of internal control that should be subject to management's assessment procedures, management's documentation of its procedures, the testing required to support management's assessments, and management's evaluation of internal control deficiencies. Additionally, we believe that as issuers and auditors continue to gain real experience in implementing the new rules and standards in 2004, additional questions will emerge that affect either the issuer, the auditor, or more likely both, and in this regard there will be a need for a process to obtain additional guidance from both the SEC and PCAOB in tandem.

**Additional Recommendation on 2004 Reporting Requirements**

Issuers and auditors are making significant first-year efforts on the implementation of the SEC's rule and the PCAOB's auditing standard regarding Section 404 internal control reporting. We expect a very high level of effort through the date that financial statements, management reports on internal control over financial reporting, and related auditor reports are filed in 2005. In light of the additional first-year effort inherent in the Section 404 internal control reporting requirements and to promote the highest quality in this first-year undertaking, we believe that the SEC should consider suspending for one year the further acceleration of Form 10-K filing deadlines in 2005 (accelerated from 90 to 75 days subsequent to year end and by existing rule to be further accelerated to 60 days) and instead retain the current schedule for this year.

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Mr. Jonathan G. Katz

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We appreciate the opportunity to provide these comments, and we would welcome discussion of any points that require further explanation.

Respectfully submitted,

*Ernst + Young LLP*