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July 12, 2007

Ms. Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Proposed Rule on PCAOB Auditing Standard No. 5
and Related Independence Rule and Conforming Amendments
Commission File No. PCAOB-2007-02

Dear Ms. Morris:

Ernst & Young LLP is pleased to comment on the Securities and Exchange Commission's (the "Commission" or the "SEC") proposed rule on PCAOB Auditing Standard No. 5, *An Audit of Internal Control Over Financial Reporting That is Integrated with an Audit of Financial Statements* ("AS 5"), and Related Independence Rule and Conforming Amendments. We strongly support the Commission's proposed rule approving AS 5, and the related independence rule and conforming amendments.

In our February 26, 2007 letter to the PCAOB, we strongly agreed with the PCAOB's observation that auditing and reporting on internal control over financial reporting has produced significant benefits and protections to investors by fostering greater focus on corporate governance, enhanced audit committee oversight, improvements in the quality and efficiency of important corporate processes and controls, higher quality financial reporting, and enhanced transparency. We believe AS 5 (along with the related independence rule and conforming amendments) accomplishes the PCAOB's goals of focusing the auditor on the matters most important to internal control, eliminating unnecessary procedures, allowing for scalability to companies of all sizes and complexity, providing auditors the opportunity to incorporate knowledge obtained during past audits, and simplifying and shortening the standard.

While we believe that AS 5 will help auditors of accelerated filers that already have been through the most challenging aspects of initial Section 404 implementation, we believe AS 5 will be particularly helpful to the auditors of those issuers that have not yet implemented Section 404. AS 5 is more principles-based and provides for wider use of professional judgment. We continue to believe that this will permit auditors to tailor a company's audit to its particular facts and circumstances, which will significantly aid the auditor's ability to scale the audit to reflect the size and complexity of the company.

The broader use of professional judgment is reflected throughout AS 5. A natural outcome of principles-based auditing standards that provide for wider use of professional judgment will be that auditing firms and individual auditors may not always interpret and apply such standards uniformly or agree on how they should be applied in a particular circumstance. Accordingly, the PCAOB inspection process must respect the range of possible judgments that auditing firms and individual auditors may appropriately make under principles-based standards and the alternative and equally acceptable approaches and methods they may choose to employ. Constructive discussions and challenges as to the scope and nature of procedures chosen are always an appropriate and needed part of the inspection process, but the inspector's judgment cannot be viewed as usurping that of the auditor as long as the principles outlined in the auditing standards have been complied with.

In the attachment to this letter we provide additional comments and observations related to the subject matter of the questions for which the Commission has solicited additional comments.

The efforts over the past year by the Commission and the PCAOB regarding the improvement of Section 404's implementation have been significant. We would like to take this opportunity to commend the respective staffs for their professionalism, achievements, and continued dedication.

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We would be pleased to discuss our comments with the Commission or its staff at your convenience.

Very truly yours,

Ernst & Young LLP

PCAOB Auditing Standard No. 5

Materiality
We believe the standard of materiality is appropriately defined throughout AS 5 to provide sufficient guidance to auditors. Paragraph 20 of AS 5 states that the auditor should use the same materiality considerations for the audit of internal control over financial reporting that are used for the audit of the financial statements. This includes matters to be considered in all aspects related to planning the scope of an audit, including the identification of significant accounts and disclosures, relevant assertions, and likely sources of misstatement. Paragraph 21 of AS 5 further illustrates the standard of materiality to be used by stating that the top-down approach "directs the auditor's attention to accounts, disclosures, and assertions that present a reasonable possibility of material misstatement to the financial statements and related disclosures." In our view, the general principles and guidance throughout AS 5 provide the foundation for the auditor to plan and execute the integrated audit at an appropriate level of materiality.

Evaluating Deficiencies
We believe that paragraph 3 of AS 5 clearly states the objective of the audit of internal control over financial reporting — that is, to plan and perform the audit to obtain competent evidence that is sufficient to provide reasonable assurance about whether material weaknesses exist as of the date specified in management's assessment. We do not believe that the requirement in paragraph 80 for the auditor to consider whether there are any deficiencies or combination of deficiencies that are significant deficiencies detracts in any way from the auditor's overall objective of determining whether any material weaknesses exist. We agree with the PCAOB that certain matters that are less severe than a material weakness might still merit the attention of the audit committee or others responsible for oversight of the company's financial reporting. However, we believe that AS 5 provides appropriate guidance and direction to auditors to focus on those matters that, individually or in combination, are material weaknesses and then consider whether any other identified deficiencies are significant deficiencies that warrant the attention of the audit committee.

We also believe that the note to paragraph 65 of AS 5 provides clear guidance to auditors regarding the aggregation of control deficiencies. Specifically, paragraph 65 states that "the auditor should determine whether individual control deficiencies *that affect the same significant account or disclosure, relevant assertion, or component of internal control* collectively result in a material weakness" (emphasis added). We believe this provides helpful guidance to auditors, although in our experience auditors have been aggregating deficiencies only if they related to the same significant account, disclosure, or component of internal control.

Definition of Material Weakness
We believe the definition of material weakness in paragraph A7 of AS 5 is appropriate for auditors to evaluate whether deficiencies exist that would prevent a conclusion that internal control over financial reporting is effective.

Using the Work of Others
We believe AS 5 is sufficiently clear about the extent to which auditors can use the work of others. As discussed in our comment letter to the PCAOB dated February 26, 2007 on the proposed standard, we believe that the existing guidance in AU section 322, supplemented with appropriate language in AS 5 relating to the use of the work of others in an integrated audit, provides an appropriate single framework for considering the extent to which the auditor can use the work of others in an integrated audit of the financial statements and internal control over financial reporting.

Scalability
We concur with the PCAOB that scaling the audit to the size and complexity of the company is a natural extension of taking a risk-based approach to an audit and believe that AS 5 and other relevant auditing standards both encourage and enable scalability. We are not aware of any aspects of AS 5 that discourage or restrict the auditor's ability to appropriately scale an audit.

Effect on Costs of Implementation
We expect that the implementation of AS 5 and continuing improvements in issuers' internal assessment processes — whether a result of the application of the SEC guidance for management or improvements and efficiencies gained through experience or likely a combination of both — will reduce total costs of implementation as compared to those which would be expected under Auditing Standard No. 2 and prior to the issuance of the SEC management guidance. In addition, we believe that smaller public companies that have yet to implement Section 404 may benefit the most from management's consideration of the SEC management guidance and the auditor's implementation of the principles and guidance in AS 5.

However, audit firms, issuers, and regulators have all observed that the nature and quality of management's assessment under Section 404 can have a direct effect on the amount of work the auditor must perform, particularly with respect to opportunities for the auditor to use the work of others. Therefore, we continue to believe that active collaboration among management, the audit committee, and the company's auditors is essential to achieving desired effectiveness and efficiency.