

May 17, 2004

Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Re: File No. PCAOB-2004-03

Dear Mr. Secretary:

The Center for Public Company Audit Firms of the American Institute of Certified Public Accountants (“AICPA”) respectfully submits the following written comments on the proposed rule that the Public Company Accounting Oversight Board (the “Board” or the “PCAOB”) has filed with the U.S. Securities and Exchange Commission (the “SEC” or the “Commission”), Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements* (the Standard). The Center was established by the AICPA to, among other things, provide a focal point of commitment to the quality of public company audits and provide the SEC and the PCAOB, when appropriate, with comments on its proposals on behalf of Center member firms. The AICPA is the largest professional association of certified public accountants in the United States, with more than 330,000 members in business, industry, public practice, government, and education.

The AICPA has long supported reporting on the effectiveness of internal control over financial reporting by public companies accompanied by auditor attestation because effective internal control is a critical component of reliable financial reporting. We believe that this practice will lead to increased quality in the preparation of financial statements. As a result, we support the SEC’s approval of the Standard.

In this letter we have not reiterated any of those comments contained in our PCAOB comment letter dated November 21, 2003. Rather we have limited our comments to those areas where we believe actions are needed by the SEC to improve the quality of the implementation of Section 404.

Guidance Regarding Access to Capital Markets

The Standard requires the auditor to express an adverse opinion on a company’s internal control over financial reporting if one or more material weaknesses exist, even in situations where a material weakness is not pervasive to the company. There is uncertainty among issuers, investors and the capital markets in general as to whether an issuer with an unqualified opinion on its financial statements and an adverse opinion

on its internal control over financial reporting will continue to have access to the capital markets. As a result, we believe the SEC should provide information about the acceptability of adverse reports on internal control included in SEC filings.

Relief for First-Time Filers

There are a number of situations which could cause a company to become an accelerated filer during the transition period to implement Section 404. The most common relates to when an existing issuer determines whether it is an accelerated filer based on its market capitalization six months prior to year end. The recent up tick in the market may have created many accelerated filers who will have great difficulty preparing for the filing. We believe that this is an unintended consequence. Many of these issuers may not be prepared to meet the requirement and are the very reason the Act sought to defer issuers of this size. To provide such issuers with sufficient time to prepare to meet the requirements of Section 404, we believe that a one year deferral should be provided to issuers meeting the market capitalization requirements for the first time in 2004.

Deferral of Form 10-K Filing Date

We recommend that the Commission defer for one year until December 31, 2005 implementation of the accelerated filing date, from 75 days to 60 days after year end, by which accelerated filers must file their Forms 10-K. This would provide these issuers with needed time to address the substantial requirements of Section 404.

Internal Control at Investees and Acquisitions Made Close to Year End

In many situations, an issuer will not be able to access information about the internal control of an investee that will be consolidated in the issuer's financial statements, for example, a variable interest entity or an entity that is accounted for using proportionate consolidation. In these situations, the issuer may lack sufficient control over the investee to access its books and records and obtain information about the investee's internal control. In addition, the issuer may not have the time necessary to make an appropriate evaluation of internal control over the financial reporting of entities acquired close to the end of the year. We believe that the SEC should allow issuers to exclude these situations from their assessment of internal control over financial reporting and report without reference to the limitation in scope.

Need for Guidance Concerning the Extent of Management Testing Required

Issuers appear to hold widely differing views about the extent of tests of controls needed to provide sufficient evidence to support management's assessment, including how monitoring controls and other aspects of the control environment affect the extent of testing. We urge the SEC to develop definitive guidance for preparers on the extent of testing. Furthermore, such guidance needs to make it clear that the auditor's testing cannot be used as the basis for management's assertion about the effectiveness of internal control.

In general, and as it relates to control activities in particular, we believe that management's extent of testing needs to be, *at a minimum*, at the same level as the auditor's for management to have sufficient evidence to

provide a basis for its assessment. This concept needs to be applied on an overall basis. It should recognize that the controls tested and the nature of tests might differ, however, management's testing needs to provide the same level of reasonable assurance that is required of the auditor, and therefore the level of evidence to support management's assessment should be at least equal to the level of evidence obtained by the auditor.

Level of Documentation Required

We believe the SEC needs to provide guidance regarding the level of control documentation that management is required to develop and maintain. The current lack of guidance has created confusion as to what to document, which in turn has resulted in inconsistent documentation among issuers. We believe management should be required to document all significant controls as it relates to the significant accounts at all locations that are either individually significant, or individually insignificant but when aggregated could result in a material misstatement to the financial statements. Without appropriate documentation, we do not believe management can demonstrate adequate company-level controls since documentation of controls is a foundation of company-level controls.

Further we believe management should have at least a minimum level of documentation of controls at locations or business units that individually and in the aggregate would not create a material misstatement, consistent with the requirement that issuers must maintain adequate books and records.

Requirements Regarding the Retention of Documentation

Issuers need more definitive guidance regarding the retention requirements for documentation supporting management's assertion about the effectiveness of internal control. We do not believe the auditor should be a repository for the workpapers and electronic files that provide evidence of management's evaluation of internal control over financial reporting at a point in time. Such an option would be unworkable for the auditor. Instead, we believe that management should be required to retain the documentation for the required statutory period, a period no less than the auditor would be required to retain the documentation.

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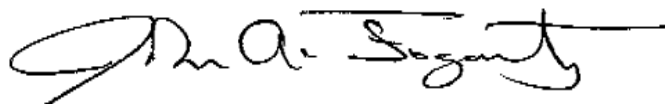
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The AICPA appreciates the opportunity to provide comments on the proposed rule. We are firmly committed to working with the SEC and PCAOB in accomplishing the timely and effective implementation of the Act and again want to reiterate the importance of issuing clear, concise, and understandable rules to the firms and practitioners that will be affected by these rules. We would welcome the opportunity to meet with you to clarify any of our recommendations.

Sincerely,



Robert J. Kueppers
Chair
Center for Public Company Audit Firms



John A. Fogarty
Chair
Auditing Standards Board

cc: Chairman William H. Donaldson
Commissioner Cynthia A Glassman
Commissioner Harvey J. Goldschmid
Commissioner Paul S. Atkins
Commissioner Roel C. Campos

William J. McDonough, Chairman of the PCAOB
Kayla J. Gillan, Member
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