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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

Members and Staff of the Commission:

BDO Seidman, LLP respectfully submits the following comments regarding the proposed auditing standard (the "proposed standard") filed with the Securities and Exchange Commission (the "SEC") by the Public Company Accounting Oversight Board (the "PCAOB"), Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements*. This proposed auditing standard governs the independent auditor's reporting on management's assessment of the effectiveness of internal control over financial reporting and on the effectiveness of internal control, referred to in Sections 103(a)(2)(A) and 404(b) of the Sarbanes-Oxley Act of 2002 ("the Act"). BDO Seidman, LLP is pleased to serve on the Task Force of the AICPA considering implementation issues and the AICPA Task Force that developed draft standards prior to the effective certification date of the PCAOB, and since that date has been working with others in the profession to address practical implementation issues.

We recognize the importance of establishing and enforcing standards that will restore confidence in our financial reporting environment, and we support the efforts of the PCAOB and the SEC to advance the quality of our professional standards. We appreciate the dedicated effort necessary to develop quality standards.

Lack of Preparer Guidance

At the time of our response to the PCAOB exposure draft we prominently noted our concern that the preparer community lacked effective guidance relating to the extent of documentation and testing required to meet its responsibilities under Section 404 of the Act and the related SEC rules. We continue to be extremely concerned that auditors would be required to express an audit opinion covering a subject matter that is effectively "undefined." Recent speeches of SEC staff have noted that the proposed standard provides implied guidance to preparers. However, this "implied guidance" is not clear to us. This lack of specific preparer guidance continues to create a divergence of views in the preparer and auditor communities over what preparers must do.

We urge the Commission to provide timely, draft interpretive guidance regarding issuer responsibilities as soon as possible. We understand that the SEC may issue interpretive guidance on some issues, but not until after the auditing standard is effective. One such issue we understand the SEC is considering is whether certain entities should be



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included in the scope of the audit of internal controls. While this issue is already discussed in the proposed standard, the preparer does not have any indication at this time regarding whether or when such guidance will be issued. We note that there are only seven months until the effective date at which the first accelerated filers are required to report on their internal controls. While we understand the desirability of awaiting the final rulemaking process regarding PCAOB auditing standards before providing further guidance to issuers, we believe that delays in providing the views of the SEC on interpretations and guidance regarding critical scoping questions are not in the public interest, place considerable strain on the preparer and auditor community, and may create significant inefficiencies.

We also ask the SEC to urge the PCAOB to provide, on a timely basis, guidance on any issues on which it has reached a preliminary consensus, even though such guidance may need to be qualified that it represents preliminary views. The continued environment of uncertainty regarding the implementation of a lengthy and complex auditing standard on a subject matter never before required, requires action to avoid unnecessary conflicts, inefficiencies and inconsistent application of the proposed standard.

Lack of Document Retention Guidance - We urge the SEC to consider issuing specific guidance requiring the retention of internal controls documentation and testing by preparers. We believe that preparers should maintain an archived copy of the controls documentation that relates to each year's required management assertion. We also believe that the SEC should explicitly state that any specialized software, licenses or tools needed for the auditor (or others) to review the documentation of the entity should be made available to the auditor and regulators.

Some believe that such an archived, indexed record may already be required under regulations requiring the retention of documentation supporting matters contained in SEC filings or under the existing "books and records" provision of the Exchange Act (Section 13(b)). We do not think these provisions are currently worded specifically enough to clearly require the retention of management's support for its 404 assertion. Further, we have observed that the need to retain such documentation continues to not be universally recognized as a requirement by all preparers. Therefore, SEC rules or the final standard should be amended or interpreted to indicate that "the adequate retention of documentation of controls, evaluation of design effectiveness, and testing and monitoring of operating effectiveness" is an expected attribute that could, if absent, be a presumptive indicator of a material weakness.

Accelerated Filing Issues

A number of companies, as a result of the general improvement in equity market conditions, may first meet the capitalization requirements defining an accelerated filer at an upcoming measurement date (e.g., May or after). We believe that in many cases it will not be appropriate or reasonable to require these entities to report on internal controls at their next annual reporting date (in some cases with essentially 6 months notice). Therefore, we ask the SEC to exclude from 2004 compliance with the proposed



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standard those companies meeting the definition of an accelerated filer for the first time this year. We are aware of companies currently seeking advisors who are unable to retain such services due to the lack of available market resources. Auditors are also trying to identify ways of meeting the time-sensitive year-end staffing demands that they currently face. We believe that, unless exempted for 2004, the current requirements will cause an excessive burden on new accelerated filers, and may be disruptive to their businesses and draining to auditor resources as these filers struggle to meet these sometimes previously unanticipated tight deadlines for reporting on internal controls in a severely concentrated time frame.

Additionally, all accelerated filers will be under shorter deadlines this year to close the books and file their required reports with the SEC. This is a challenge in itself, and is compounded by the requirement to make the "as of" year-end date assertion regarding the effectiveness of internal controls. The proposed standard appears to set a nearly zero tolerance standard for any deficiencies arising in the closing process, and due to the timing of the closing process, the timing itself effectively precludes remediation of any significant deficiencies or material weakness that may arise in that process. Compounding this concern, some services with which auditors may have previously assisted preparers are no longer permitted, requiring preparers to accomplish these tasks in a new way for the first time this year.

Accordingly, we ask the SEC to consider whether, in light of the very significant requirement to assess and report on internal controls, shortening the filing deadline as scheduled is an appropriate action, as confounding factors are likely in our view to impair, rather than improve, the quality of reporting until experience is gained in the new environment and auditor and preparer resources are more experienced in performing their new respective tasks.

An alternative approach would be to significantly increase the amount of public float required to meet the definition of an accelerated filer. We would strongly support such an action. In addition to addressing our concerns outlined above, it would reduce what we perceive to be an excessive burden on the smallest accelerated filers and enhance their ability to maintain quality reporting. Our experience in working with several companies whose public float borders on the \$75 million amount in Rule 12b-2 indicates that meeting the accelerated due dates while maintaining quality reporting has been or will be a significant challenge.

Excessive Procedures Required by the Standard

Despite improvements made in the proposed standard over the exposure draft, we continue to be concerned that the proposed standard may, in some circumstances lead to the performance of procedures in excess of what is really required during an audit of internal controls.

We generally concur with the PCAOB's conclusions concerning when the auditor should and should not rely on the work of others when determining the nature and extent of



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procedures necessary to support the auditor’s opinion, and we agree with the direction that auditors need to closely examine certain sensitive judgmental areas. These requirements are responsive to the issues that gave rise to the Act. However, in certain areas the Standard continues to require the performance of many specific procedures by the auditor, and identifies constraints on the exercise of auditor judgment.

We also believe the proposed standard requires the auditor to comply with vague and undefined overarching requirements that the auditor obtain the “principal evidence” regarding the audit of internal controls and test a “large portion” of the controls, which creates an environment of uncertainty when applying the provisions of the standard. Unless this requirement is clarified, we expect those concepts to encourage the application of unnecessary procedures, beyond those specified by the relevant guidance in the standard or assessed by the auditor to accomplish the objectives of the audit. We are concerned that these undefined requirements might distract auditors from directing scarce resources to problem situations.

We believe that interpretations of these terms and how they can be satisfied need to be provided now, as audit engagement teams begin their review and testing.

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We appreciate your consideration of our comments and suggestions, and would be pleased to communicate or meet with the SEC and its staff to clarify any of our comments.

Please direct comments to Wayne Kolins, National Director of Assurance at 212-885-8595 Wkolins@bdo.com or Lynford Graham, National Director of Audit Policy at 212-885-8551 Lgraham@bdo.com.

Sincerely,

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