

May 17, 2004

Jonathan Katz
Secretary
Securities and Exchange Commission
File No. PCAOB-2004-03
Release No. 34-49544
Via email

**Invitation to Comment on
PCAOB Rulemaking:
“Public Company Accounting Oversight Board; Notice of Filing of Proposed Rule on Auditing
Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction with
an Audit of Financial Statements*”**

We appreciate the opportunity to respond to the Proposed PCAOB Rulemaking “Public Company Accounting Oversight Board; Notice of Filing of Proposed Rule on Auditing Standard No. 2, An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements” (Rule). We rank among the largest providers of telecommunications services in the United States and the world. We provide communications services and products in the United States and have investments in more than 25 countries. We are a Fortune 40 company, employing approximately 170,000 people as of December 31, 2003.

We are supportive of the Commission’s and the PCAOB’s efforts to provide constructive guidance surrounding the issue of auditing internal controls. The Rule describes a process that is long and complex requiring great care and diligence if it is to be performed correctly. We believe that the Rule appropriately discusses areas that the auditor and management need to consider to be able to make the necessary compliance statements in their annual public filings.

We are concerned, however, with a consideration that arises from the very complexity of this issue. The language of the Rule demonstrates this complexity. Just a few examples from the Rule:

- Paragraph 13 notes that management must use a “suitable, recognized control framework..”
- Paragraph 20 requires management to evaluate control effectiveness, support the effectiveness with sufficient evidence, including documentation, and provide a formal written assessment.
- Paragraph 30 requires the auditor to plan the audit, evaluate management’s assessment process, understand the controls, test and evaluate design and operating effectiveness of controls, and form an opinion of the controls.
- Paragraph 33 emphasizes that management’s involvement in the process must be substantive and extensive; it cannot merely accept information prepared by the auditors.
- Paragraphs 42-46 highlight this extensiveness in the controls documentation requirements.
- Paragraph 79 requires that the auditors’ testing must also include walkthroughs.

All of these suggest a lengthy process if the evaluations by management and the auditors are to be done effectively and comply with both the letter and the spirit of the law.

We agree that this process, completed properly, involves this level of complexity. We began our own evaluation, documentation and testing process in 2003 to assure that we would be ready for the 2004 certification and audit processes. We can confirm that the process described by the Rule is effective in allowing management to make an assessment of its internal controls. However, we can also confirm that

the process is as lengthy as that suggested by the text of the Rule. For an evaluation to have substantive merit, the first time through a set of controls will be very time-consuming.

Where the lengthiness of the process becomes an issue is the proposed requirement that the audit, and therefore the management assessment and certification, applies to controls in effect as of the end of the company's most recent fiscal year. While this is certainly appropriate for controls that were in effect throughout the entire year or where the company-implemented changes in control systems, we do not believe that it is appropriate for controls related to a subsidiary that became part of the consolidated financial statements during the year. At the extreme, if a company acquired another company on the last day of its fiscal year, it would not be physically possible to complete the entire control evaluation and audit process in a day. The result is a situation where management is likely not to be in a position to express an opinion on the new subsidiary's internal controls but may be treated unfairly for excepting that new subsidiary from the attestation process.

Statement of Financial Accounting Standards No. 141 allows for a one-year period in which to true up the allocation of purchase price, suggesting that no balance sheet or related income statement could be considered truly final until that true up is complete. This is the same period of time its predecessor statement also allowed, so it has been a long established practice in Generally Accepted Accounting Principles (GAAP) that new subsidiaries require an extended period of time for the consolidating entity to truly evaluate. It seems reasonable to implement a similar one-year period for internal controls evaluations, particularly in the current situation where the rules are still under development.

In addition to this GAAP treatment, our own experience has shown that the initial evaluation process takes several months to complete, and that is with controls and systems with which the company was already familiar. There would naturally be an added burden to completing an evaluation process of a new consolidated subsidiary. As any company that has experienced significant business combinations, as we did in our combinations with, among others, Pacific Telesis, Southern New England, Ameritech and Sterling Commerce, can confirm, integrating a new entity into consolidated financial statements is a challenging and time consuming process.

Therefore, we recommend the Commission amend the Rule to state that the audit and related management assessment and certification does not need to include entities that became consolidated subsidiaries during the fiscal year. Any such entity that the company chooses to exclude should be listed in the certifications signed by the company's auditors and also reflected in the auditor's opinion.. This is consistent with GAAP and the length of time that it takes to perform a quality review of the controls. Because of this latter factor, it becomes problematic to complete this assessment on entities that were not consolidated subsidiaries for at least nine months.

We appreciate the opportunity to comment on rules proposed by the Commission. If you would like to further discuss any of our comments, please do not hesitate to contact either Andrew Libera, Executive Director – External Reporting and Accounting Policy at (210) 351-3043 or myself at (210) 351-3900.

Yours very truly,

John J. Stephens
Vice President and Controller