



Public Company Accounting Oversight Board

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Board Issues Report on Initial Implementation of Auditing Standard No. 2

Washington, DC, November 30, 2005 – The Public Company Accounting Oversight Board today issued a report discussing issues identified in the course of the Board's monitoring of the implementation of Auditing Standard No. 2, An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements. That standard implements Sections 103 and 404 of the Sarbanes-Oxley Act of 2002 by establishing a process for auditing a public company's internal control over financial reporting in conjunction with an audit of financial statements.

The Board found that both firms and issuers faced enormous challenges in the first year of implementation, including strains on available resources; a shortage of staff with prior training and experience in designing, evaluating, and testing controls; and the limited timeframe that issuers and auditors had to implement Section 404. These challenges were compounded in cases in which companies needed to make significant improvements in their internal control systems to make up for deferred maintenance of those systems.

The Board's monitoring revealed that some audits performed under these difficult circumstances were not as effective or efficient as Auditing Standard No. 2 intends and as the Board expects they can be in the future, given the benefits of experience, adequate time and resources.

"While our inspections identified several opportunities for auditors to improve audit quality and efficiency, the Board remains confident that auditors will be able to perform more effective and efficient audits in future years," said PCAOB Chairman William J. McDonough. "These improvements are already appearing as auditors and their clients gain experience and as challenges that were unique to the first year's implementation abate."

The Board has identified, in its inspections and other monitoring, certain areas in which auditors should be able to make their audits more effective and efficient in the future, by obtaining sufficient evidence for an opinion in a manner that appropriately conserves time and other resources. These areas are described in the report.

The Board understands that, based on first-year experiences and on previous Board guidance, firms already have modified their audit methodologies and training materials in a number of these areas, to improve the effectiveness and efficiency of their internal control audits.

The Board previously provided guidance in its May 16, 2005, policy statement as well as in a series of staff questions and answers. The policy statement, in particular, focused on several of the auditing practices observed in the first year of implementation of Section 404 that may have been ineffective or inefficient means of meeting the objectives of Auditing Standard No. 2. It also described the PCAOB's intention to supervise implementation of the standard, from providing additional guidance to make audits of internal control more effective and cost-efficient to driving improvements in implementation through PCAOB inspections of registered public accounting firms.

The Board's observations in its report on initial implementation of Auditing Standard No. 2 are based in significant part, but not exclusively, on information obtained by the Board in the Board's inspection process, which in the 2005 cycle included review of portions of a limited selection of audits of internal control over financial reporting.

The **text of the report** is available on the Board's Web site.

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