Center for
Public Company
Audit Firms
Committed to Audit Quality

American Institute of Certified Public Accountants • Harborside Financial Center, 201 Plaza Three • Jersey City, NJ 07311–3881
201.938.3030 • 888.817.3277 • fax 201.521.5436 • www.aicpa.org/cpcaf

November 29, 2004

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

Re: PCAOB Rulemaking Docket Matter No. 015: Proposed Rule on Procedures Relating to Subpoena Requests in Disciplinary Proceedings

Members and Staff of the Public Company Accounting Oversight Board:

The Center for Public Company Audit Firms (the "Center") of the American Institute of Certified Public Accountants ("AICPA") respectfully submits the following written comments on the Public Company Accounting Oversight Board's ("PCAOB" or the "Board") proposed rule on procedures relating to subpoena requests in disciplinary proceedings (the "Proposed Rule").

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 PCAOB and the Securities and Exchange Commission, 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 340,000 members in business, industry, public practice, government and education.

The Center recognizes the enormous effort made by the PCAOB's members and staff to implement the provisions of the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act" or the "Act"). As part of that effort, the Board has proposed rules providing for the Board to seek the issuance of a Securities and Exchange Commission ("SEC" or the "Commission") subpoena to compel testimony or the production of documents from third parties in connection with a Board disciplinary proceeding pursuant to Section 105(c) of the Act. The AICPA is committed to working with the PCAOB to develop fair and effective procedures governing the issuance of Commission subpoenas in disciplinary proceedings. To that end, the AICPA appreciates the opportunity to comment on the proposed rule.

Overall, the AICPA is supportive of the Board's efforts to establish fair procedures to seek Commission subpoenas in the context of Board disciplinary proceeding. In many cases, the issuance of a Commission subpoena may be necessary to protect a respondent's right to a fair hearing. In particular, given the nature of the audit function and the frequency and range of communications between auditors and issuers, it is clear that testimony and documents provided by audit clients and their employees (as well as by other persons who are not directly subject to the PCAOB's authority) will play a central role in an untold number of disciplinary proceedings.

As discussed below, however, the proposed rule would impose numerous barriers to a respondent's ability to secure the issuance of a Commission subpoena in connection with a PCAOB disciplinary hearing, and require respondents to satisfy criteria that apparently would *not* apply when the Board's staff is seeking to enlist the Commission's assistance in connection with a prior Board investigation pursuant to Section 105(b) of the Act. In addition, the proposed rule is far more restrictive than comparable provisions in the SEC's Rules of Practice.

Accordingly, we believe that the proposed rule could be clarified and improved in several respects and offer the following comments:

Disparity Between Proposed Rule 5424(c) and Standards Applicable to Board Investigations

While the PCAOB staff likely will have broad access to potentially relevant or material information in the hands of third parties during the pre-hearing, investigatory process, the proposed rule does not ensure that a respondent will have equal access to such sources of information in preparing a defense. Specifically, it is by no means clear that the Board's staff would be subject to restrictions similar to those set forth in proposed Rule 5424(c) when seeking a Commission subpoena during a Board investigation that preceded a disciplinary proceeding.

In particular, during the course of a Board investigation, Rule 5111 provides that the Board may request that the Commission issue a subpoena, in a manner established by the Commission, for testimony or the production of documents by any person, which the Board considers "relevant or material" to an investigation. As discussed below, this is a far lower standard than would apply to requests by a party under proposed Rule 5424(c) that the Board request the issuance of a Commission subpoena in connection with a Board disciplinary proceeding. Nor is there any indication that the Board intends to apply the standards proposed in Rule 5424(c), on a prospective basis, to requests to the SEC for the issuance of subpoenas in connection with a Board investigation. As a result, there would appear to be a substantial disparity between the ability of the Board's staff to request the Commission's aid during a pre-hearing investigation and the ability of a respondent, during a subsequent disciplinary proceeding, to enlist the SEC's assistance in securing what might prove to be critical documents or testimony needed to defend Board allegations.

Proposed Rule 5424(c)(3)(i)–(iii) – Application for a Commission Subpoena

The proposed rule provides that applications for a Commission subpoena must identify and describe the evidence sought, describe the basis for the party's belief about the substance of the evidence, and explain the relevance or materiality of the evidence to the resolution of the proceeding. These requirements place an extremely high burden on the party requesting the issuance of a Commission subpoena at an early stage of a Board proceeding. In particular, the proposed standard is especially onerous, in that it essentially requires applicants to know the substance of the subpoenaed evidence in advance of receiving it.

In addition, the PCAOB's proposed rule imposes a much higher standard on subpoena applicants than would apply to the Board itself under Section 105(b)(2)(D) of the Sarbanes-Oxley Act, which provides that the Board may request the issuance of a Commission subpoena for information considered "relevant or material" to a Board investigation. The Board's proposal

is also more onerous than comparable provisions in the SEC's Rules of Practice and the procedural rules for other types of adjudications.[1]

- The SEC's Rule of Practice 232(b) places affirmative burdens on the requesting party only "[w]here it appears to the person asked to issue the subpoena that the subpoena sought may be unreasonable, oppressive, excessive in scope, or unduly burdensome . . . ." In that case, the person asked to issue the subpoena "may, in his or her discretion, as a condition precedent to the issuance of the subpoena, require the person seeking the subpoena to show the general relevance and reasonable scope of the testimony or other evidence sought." Thus, the SEC's Rules of Practice do not require subpoena applicants to clear any of the hurdles set forth in the Board's proposed rule.

- Federal Rule of Civil Procedure 45(c)(1) does not require a party requesting a subpoena to know the substance of the evidence before seeking its production. Instead, that rule merely requires an applicant to "take reasonable steps to avoid imposing undue burden or expense on a person subject to that subpoena."

- Likewise, NYSE Rule 619, which governs arbitrations, is much less demanding than the PCAOB's proposed rule: "Any request for documents or other information should be specific, relate to the matter in controversy, and afford the party to whom the request is made a reasonable period of time to respond without interfering with the time set for the hearing."

- The NASD's Rule 9252 — concerning subpoena requests in NASD disciplinary proceedings — asks more from applicants than the NYSE's rule, but is not as restrictive as the PCAOB's proposed rule. The NASD's rule requires that applicants "describe with specificity the Documents, the category or type of Documents, or the testimony sought; state why the Documents, the category or type of Documents, or the testimony are material; describe the requesting Party's previous efforts to obtain the Documents, the category or type of Documents, or the testimony through other means . . . ."

Accordingly, we suggest that the PCAOB modify the proposed rule to conform with Section 105(b)(2)(D) of the Sarbanes-Oxley Act. Such a standard, as noted, would also be consistent with Rule 232(b) of the SEC's Rules of Practice.

Proposed Rule 5424(c)(3)(iv) – "Functionally Equivalent Evidence"

The proposed rule requires subpoena applicants to address the feasibility of acquiring "functionally equivalent evidence" through means other than a Commission subpoena. The

[1] NYSE and NASD rules allow parties to request information from third parties, but neither has the authority to compel the production of evidence from third parties.

proposed rule, however, does not define "functionally equivalent evidence." Instead, the Board's proposing release merely indicates that "the Board anticipates that parties, acting in their own self-interest, will routinely seek to secure relevant documents and testimony on a voluntary basis, since there is no assurance in any case of obtaining a subpoena."

- The concept of requiring a respondent to seek "functionally equivalent evidence" prior to requesting the issuance of a subpoena is not addressed in the SEC's Rules of Practice.

- Similarly, neither the Federal Rules of Civil Procedure nor the NYSE rules address the concept.

- The NASD's rules prescribe a duty to try to obtain the evidence in good faith. Specifically, NASD Rule 9252(b) ("*Standards for Issuance*") provides that a subpoena applicant must show that it "previously attempted in good faith to obtain the desired Documents and testimony through other means . . . ."

Accordingly, we suggest the elimination of this provision from the proposed rule. While respondents may seek information from third parties on a voluntary basis, requiring respondents to address this point in a subpoena application (which implies that the Board expects applicants to expend some effort to secure information on a voluntary basis) likely would prove difficult to reconcile with the accelerated timeframe contemplated by the proposed rule. Moreover, the perceived availability of "functionally equivalent evidence" — an undefined and ambiguous term — should not serve as the basis for denying a subpoena application.

Proposed Rule 5424(c)(4) – Hearing Officer's Review of the Subpoena Application

The proposed rule provides that the hearing officer may recommend that the Board seek a Commission subpoena *only* if he or she determines that (1) the general nature and substance of the documents or testimony sought is not a matter of speculation, *and* (2) the unavailability of the evidence may bear on the Board's ability to provide a respondent with an opportunity to defend. Even if both conditions are present, however, the hearing officer retains discretion to deny a subpoena application in light of his or her judgment regarding how best to manage the case.

In contrast, Rule 232(b) of the SEC's Rules of Practice states that if the person requested to issue the subpoena "determines that the subpoena or any of its terms is unreasonable, oppressive, excessive in scope, or unduly burdensome, he or she may refuse to issue the subpoena, or issue it only upon such conditions as fairness requires." Absent those circumstances, however, a subpoena request will not be denied.

Moreover, as noted, the PCAOB's proposed rule would require the hearing officer to determine that the unavailability of the requested information will bear on the respondent's "opportunity to defend." Conceivably, under this formulation, a hearing officer might believe that the information at issue was highly relevant to a respondent's ability to defend against Board allegations, but nevertheless determine that the application should be denied because it would not

bear, in some unspecified manner, on the respondent's "opportunity to defend" the charges. In addition, the proposed rule would provide the hearing officer with the discretion to deny the application, even if the requested information was essential to the defense of a Board proceeding.

Accordingly, we believe that the purpose of the proposed rules should be to provide respondents with a "fair" opportunity to defend, and providing hearing officers with unfettered discretion to deny respondents access to relevant and potentially critical information fails to achieve that goal. In addition, we recommend that the proposed rule be amended to conform to the SEC's Rules of Practice regarding the issuance of subpoenas and to remove the hearing officer's discretion to deny applications where the standards for issuance appear to be satisfied.

Proposed Rule 5424(c)(5) and (6) – Documentation of a Hearing Officer's and the Board's Denial of a Subpoena Application

Proposed Rule 5424(c)(5) requires a hearing officer to include a written description of the reasons for recommending that the Board seek a Commission subpoena. While the proposed rule requires the hearing officer to issue a written denial of the application, it does not require the hearing officer to state his or her reasons for rejecting the applicant's request. In short, a hearing officer must provide written justification for the approval of an application, but not for the denial of one.

Likewise, under proposed Rule 5424(c)(6), when the Board rejects a hearing officer's recommendation of a subpoena application and decides not to request a subpoena from the Commission, the Board is not required to document in writing its reasons for denying the application; the proposed Rule requires only that the Board notify the parties in writing of its decision.

We, therefore, suggest that the Board revise the proposed rule to require the hearing officer and the Board to set forth in writing the specific basis for denying a party's subpoena application. These are fundamental rulings that could significantly impact a respondent's right to a fair hearing and that there should be a clear and complete record of the basis for such rulings.

Proposed Rule 5424(c)(6) – The Board's Ability to Issue a Subpoena Sua Sponte

The proposed rule would permit the Board, after receiving the recommendation for seeking a Commission subpoena from the hearing officer, to determine *sua sponte* not to request the subpoena from the SEC, without submission or argument by the parties unless the Board so requests.

We believe that the Board should also be able to request the issuance of a subpoena on its own motion, notwithstanding a hearing officer's initial decision. This would allow the Board to step in to prevent situations from arising where a hearing officer's denial of a party's application would clearly prejudice the party's right to a fair hearing. Furthermore, it would promote the consistent evaluation by the Board of decisions by hearing officers with respect to subpoena requests. This would appear particularly important at least until the Board and its hearing officers have gained more experience in conducting disciplinary proceedings under the Board's

rules and have more of a "track record" in addressing situations where the availability of third-party information is an important issue.

We note that, for the Board to be able to issue a subpoena on its own initiative after a hearing officer's denial of the request, there would need to be a procedure by which such denials would come before the Board. Given the general standard applicable to interlocutory appeals under the Board's Rule 5461, it is unlikely that an appeal from a hearing officer's decision denying a subpoena application would be certified for interlocutory review. Accordingly, we suggest that the proposed rule be amended to require hearing officers to forward to the Board a written record of their reasons for denying a subpoena application (as suggested above) and to allow specifically for Board review of such decisions. Under this approach, all hearing officer decisions with respect to subpoena applications would be documented and forwarded to the Board for its review and possible action.

Proposed Rule 5424(c)(8) – 30-Day Window for SEC Action

Proposed Rule 5424(c)(8) provides that, once the Board approves the hearing officer's recommendation to seek a subpoena and transmits the request to the SEC, the hearing officer may set an appropriate hearing schedule, leaving a reasonable amount of time for the SEC to act on the subpoena request. The proposed rule furthermore provides that, in the absence of any action by the Commission on a subpoena request within 30 days of the Board's request, and in the absence of unusual circumstances warranting further delay, the hearing officer shall proceed with the matter as if the Commission had denied the request.

In short, the proposed rule would have a disciplinary proceeding continue without the benefit of relevant and potentially critical information if there is a delay in the Commission's response. Particularly in light of potential issues that may arise when a foreign registered public accounting firm seeks to have a subpoena issued (or generally when a subpoena addressed to an entity based outside of the United States is sought), we believe that such a course of action is not appropriate and should not be followed. We also believe that the PCAOB and the Commission need to reach an understanding regarding the appropriate level of coordination necessary to handle these matters and to avoid placing respondents' right to a fair hearing at risk.

Proposing Release – "Reasonably Available" Evidence under Rule 5424(c)

The release accompanying proposed Rule 5424(c) states, in its discussion encouraging parties to secure evidence from third parties voluntarily, that the PCAOB does not intend that the rule be used in circumstances where the evidence is "reasonably available without being compelled by subpoena," and that the Board expects hearing officers to consider this policy when exercising their discretion to deny applications.

It is unclear what "reasonably available" means in this context. For example, does the PCAOB expect an audit firm to exert pressure on an audit client or its employees to produce documents or testimony in connection with an ongoing PCAOB proceeding, perhaps by advising the client that the audit firm will not undertake future work for the client, unless the client agrees to produce documents or make personnel available for testimony? Imposing such an indirect

requirement on registered public accounting firms could have a negative effect on auditors' relationships with their clients and appears ill-advised.

We believe that, similar to the comment regarding "functionally equivalent evidence, " whether evidence is perceived by a hearing officer to be "reasonably available" — an undefined and ambiguous term — should not serve as the basis for denying a subpoena application.

Proposed Rule 5424(c) General – Motions to Quash or to Modify

Proposed Rule 5424(c) makes no provision for motions to quash or to modify subpoenas issued pursuant to the Rule. The procedural rules established for other types of administrative proceedings include mechanisms by which interested parties can move to quash or to modify such subpoenas. For example:

- SEC Rule of Practice 232(e) provides a procedure and a standard for motions to quash or modify subpoenas:

    i. "Any person to whom a subpoena is directed, or is an owner, creator, or the subject of the documents that are to be produced pursuant to a subpoena" may, within a specified time, request that the subpoena be quashed or modified.

    ii. "If compliance with the subpoena would be unreasonable, oppressive or unduly burdensome," the competent authority "shall quash or modify the subpoena, or may order return of the subpoena only upon specified conditions."

- The Federal Rules for Civil Procedure provide a similar standard:

    i. Under FRCP 45(c)(3)(A), a subpoena shall be quashed or modified if it "fails to allow reasonable time for compliance," requires unreasonable travel by a nonparty witness, "requires disclosure of privileged or other protected matter and no exception or waiver applies," or "subjects a person to undue burden."

    ii. Under other circumstances the court may decide not to quash or modify the subpoena, but instead ensure that the "person to whom the subpoena is address will be reasonably compensated."

Accordingly, we recommend that, in the interest of promoting both a respondent's right to a fair hearing and protecting third parties from unduly burdensome subpoenas, the PCAOB or the SEC should adopt procedures by which affected parties can move to quash or to modify subpoenas issued pursuant to the Rule.

Proposed Rule 5424(c) General – Need for Complementary PCAOB and SEC Rules

While proposed Rule 5424(c) addresses how the PCAOB might seek the issuance of a subpoena from the SEC in connection with a disciplinary proceeding before the Board, it does

not specify how the Commission intends to act upon such applications. This presumably would be the topic of separate, later rulemaking by the Commission.

We strongly believe that *both* the final PCAOB rule *and* any "companion" SEC rules that address how the Commission intends to handle Board requests for the issuance of a subpoena should be in place before the Board conducts any disciplinary proceedings involving specific registered public accounting firms or their associated persons. Without *both* sets of rules in place and available to respondents, a respondent's right to a fair hearing could be substantially prejudiced.

* * * * *

We appreciate the opportunity to comment on the Board's Proposed Rule. We are firmly committed to working with the PCAOB in accomplishing the timely and effective implementation of the Act, and 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

cc: Mr. William J. McDonough, Chairman, PCAOB
Ms. Kayla J. Gillan, Member, PCAOB
Mr. Daniel L. Goelzer, Member, PCAOB
Mr. Willis D. Gradison, Member, PCAOB
Mr. Charles D. Niemeier, Member, PCAOB