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

Re: Rulemaking Docket Matter No. 17

Mr. J. Gordon Seymour:

Ernst & Young LLP (EY) is pleased to comment on the *Concept Release Concerning Scope of Rule 3523, Tax Services for Persons in Financial Reporting Oversight Roles, Implementation Schedule for Rule 3523* as requested in PCAOB Release No. 2007-002 dated April 3, 2007. We support the PCAOB's efforts to provide and enhance guidance on the PCAOB Ethics and Independence Rules Concerning Independence, Tax Services, and Contingent Fees (the Rules) and matters surrounding implementation, particularly those aspects of the Rules that may unnecessarily impact registrant's choices when seeking to make a change in the registered firm conducting its audit. We have previously submitted comments and provided views to the Staffs of both the PCAOB and SEC on the Rules and our Firm's understanding and implementation processes surrounding these Rules.

The Concept Release indicates the Board is interested in views on whether the distinction that Rule 3523 relates to services provided to individuals and not to the audit client directly has a bearing on the nature and the extent of any independence concerns that may exist with respect to tax services provided during the audit period to persons covered by Rule 3523. The Concept Release seeks responses to two specific questions.

We have addressed these matters below:

1. Question 1

> **To what extent, if any, is a firm's independence affected when the firm, or an affiliate of the firm, has provided tax services to a person covered by Rule 3523 during the portion of the audit period that precedes the professional engagement period?**

As the Board notes, under currently existing Rule 3523, if a registered firm provides tax services during the audit period, but before the commencement of the professional engagement period, this is an impairment of independence and this violation cannot be remedied by the registered firm's ceasing to provide the tax services before accepting the engagement. Accordingly, in this circumstance, the registered firm may not become the auditor to the company. This is consistent with the SEC's auditor independence rules regarding proscribed services—i.e. that an accountant is not independent if prohibited services are provided during the audit and professional engagement period. However, a recent speech by Mr. Michael Husich, Associate Chief Accountant, Office of the Chief Accountant, provides important new thinking on this point. Mr. Husich states that in instances of potential auditor change, this occurrence will not operate to deem an accountant not independent when certain services are provided in the audit period, but prior to being appointed the auditor, so long as such services:

- relate solely to the prior period which is audited by a predecessor auditor
- will not be subject to audit procedures by the successor auditor, and
- are not management functions.[1]

With respect to the tax services contemplated by Rule 3523, the criteria above can, in most instances, be easily applied leading to enhanced consistency with the recent views of the Staff as expressed in Mr. Husich's speech. If tax services have been provided to individuals in financial reporting oversight roles (FROR) during the audit period, but prior to being appointed the auditor, applying the above criteria addresses the potential of an independence threat based on the principles of independence as found in the Preliminary Note to Regulation S-X, Rule 2-01 (b) which states.

> "In considering this standard, the Commission looks in the first instance to whether a relationship or the provision of a service: creates a mutual or

[1] Speech by Mr. Michael Husich, December 11, 2006 at the AICPA National Conference on Current SEC and PCAOB Developments. "I have a few comments concerning three matters, for which additional guidance is being considered**.** First, five of the prohibited services delineated in Rule 2-01(c)(4) (bookkeeping, financial information system design and implementation, appraisal or valuation services, actuarial services, and internal audit outsourcing services) have an exception condition, "unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the client's financial statements", also known as the "not subject to audit" provision. **The staff's position is that a successor auditor's independence would not be impaired if the successor auditor provided prohibited non-audit services in the current audit period and these services (i) relate solely to the prior period which is audited by a predecessor auditor, (ii) will not be subject to audit procedures by the successor auditor, and (iii) are not management functions." (emphasis added)**

> conflicting interest between the accountant and the audit client; places the accountant in the position of auditing his or her own work; results in the accountant acting as management or an employee of the audit client; or places the accountant in a position of being an advocate for the audit client."

While the services contemplated by Rule 3523 do not necessarily have the safeguard of being subject to the audit procedures of the predecessor auditor, they are not services provided to the audit client but, rather, to individuals who serve in FROR roles at the audit client. Indeed, it would be rare that the results of tax services provided to an individual in an FROR role would impact the financial statements at all. The fact that these services are provided to the individual and not to the audit client act to counter any mutuality of interest.

We believe the Board's concept release has recognized the significant and compelling difference between services provided to an individual who is in an FROR role and services provided directly to the audit client. The Board has already, in part, differentiated these services, as Rule 3523 has a time limited exception in Rule 3523(c) which permits continuation of a tax services engagement to a person who becomes subject to Rule 3523 due to certain changes in the individual's employment (employment events). This time limited exception already recognizes that tax services provided to an individual in an FROR role can be continued during an audit period without immediately impairing independence. We concur that services rendered to an individual in an FROR role, prior to an auditor appointment, are fundamentally different from services provided directly to an audit client. It is our view that if the Board determined to amend Rule 3523 to only encompass the "professional engagement period" as opposed to the "audit and professional engagement period" such change will not raise any new or additional independence considerations surrounding personal tax services to individuals in an FROR role. We find this consistent with the direction of Mr. Husich's speech cited above and we find that direction an appropriate balance between the importance of an auditor's independence and the ability of registrants to have adequate choices in auditor selection and not be impeded in such choices by services that do not fundamentally affect auditor independence as they were commenced and, in many cases delivered, prior to being considered to be the auditor.

We recognize in certain rare instances tax services that have been provided to individuals in an FROR role in the audit period may have an impact on the financial statements of the audit client. Such rare circumstances could be where the tax services include advice on transactions where there may be a mutuality of interest or conflicting positions between the tax treatment for the individual and

that of the employer. Should such rare circumstances arise, they could create a situation where tax services to an individual in an FROR role create the potential for an independence concern. This situation was noted in comments of the Internal Revenue Service, the Securities and Exchange Commission and the PCAOB in February 2005 concerning the transactions entered into by certain taxpayers concerning executive stock options[2]. We believe these circumstances are rare following both the reforms of the Sarbanes-Oxley Act, the PCAOB's rulemaking and operational changes incorporated into the tax practices of many accounting firms. We believe these circumstances, if they exist, would warrant more consideration and evaluation from an independence perspective prior to client acceptance but believe that the assessment should be based on the existence of the service or the relationship, not the time frame in which the service was rendered and are adequately provided for in existing literature and guidance.

2. Question 2

What effect, if any, would application of Rule 3523 to the audit period have on a company's ability to make scheduled or unscheduled changes in auditors? Could any such effect be minimized or managed through advanced planning or otherwise?

This question in the Concept Release focuses on a company's ability to make scheduled or unscheduled changes in its auditors based on the application of Rule 3523 to the audit period. An auditor change may occur relatively quickly and often under a high degree of confidentiality. This can occur in transaction driven situations and other circumstances. In other instances, the decision to consider an auditor change is made well in advance. Where possible, advance planning would minimize an effect of Rule 3523. However, advance planning is not always possible. Further, for confidentiality reasons, not all individuals in an FROR role may be informed of a company's possible evaluation of changes in its auditor.

We believe application of Rule 3523 to the audit period would serve to limit a company's potential choices among auditors. We believe this is not in the best interests of shareholders and other participants in the capital markets. Approximately 70% of the Fortune 1000 companies report their financial results on a calendar year basis. For such companies, the audit period begins January 1 and continues to December 31. Any plan to consider a change in auditor initiated after January 1 exposes the company to have fewer potential firms that can

[2] IR 2005-17 February 22, 2005 Settlement Offer Extended for Executive Stock Option Scheme and comments of the PCAOB and SEC.

perform the audit due to the application of Rule 3523 to the audit period. In addition, considering the tax filing deadline in the United States, the selection process may coincide with and overlap with April 15th - the initial deadline for U.S. personal income tax returns. It is likely that an auditor selection process which started March 1 would find that several firms would not be independent due to tax services provided to individuals in an FROR role for a period after January 1 of that year.

The above example only addresses the potential impact of the audit period beginning prior to the professional engagement period for U.S. tax compliance services in calendar year audit situations. Further conflicts will also be created when dealing with various foreign tax compliance filing requirement dates for individuals in FROR roles and/or audit clients with other than calendar year ends. As an example, in many foreign jurisdictions, there is no mechanism for the extension of tax return filing deadlines. Therefore, an announced auditor change could potentially place an individual in an FROR role in a position of considerable hardship to file a tax return on a timely basis. Absent an appropriate transition rule, the individual in an FROR role may be forced, under extreme time constraints and at a significant cost, to identify a new service provider.

We believe the hardship imposed on companies by the current provisions of Rule 3523 exist whether the auditor change is scheduled or unscheduled. Unscheduled changes often occur in a tight timeframe and provide many other issues beyond tax services to individuals in FROR roles. In the case of scheduled changes, the additional time may simplify the issue, but, often, does not. There may be more than one potential audit firm (especially in global organizations) providing tax services to individuals in FROR roles at the time of commencement of an evaluation of auditors. Even with advance planning, it is possible that confidentiality concerns may create difficulties in determining whether a potential audit firm is providing services to individuals in an FROR role. The definition of who is an FROR covers a range of individuals at both the parent company and its material subsidiaries and affiliates around the world. Should an auditor have to communicate to an individual tax service client that independence concerns relating to a possible auditor change make it impossible for the audit firm to provide the individual with tax service, that auditing firm could find itself in a position of violating a request for confidentiality during the proposal process. Again, this would be an example of putting a potential audit firm and the company in an impractical position.

Given that companies often use multiple non-audit service providers, continued application of the provisions of Rule 3523 could lead to circumstances where not only is the company restricted in its choice of audit providers but individuals in

FROR roles are restricted in their choice of tax service providers. Without this revision, it is possible that companies would adopt a policy of restricting individuals in FROR roles from using the tax services of certain audit firms. This creates a lack of choice for these individuals and quite possibly denies them access to the specialized tax services they may require.

Conclusion

For the reasons cited above Ernst & Young would strongly support if the Board determined to amend Rule 3523 to strike the words "audit and" from the current text of Rule 3523 (as identified in footnote 9 of the Concept Release). We believe this is a reasoned approach and one that does not fundamentally impact independence.

We also urge the Board to consider a further but related modification. We support a Board clarification that treats a change in auditor in a manner similar to that of a "change in employment event" as that term is defined in Rule 3523 (c). This clarification would allow the time limited exception to the rule to come to bear. We believe this change would improve standardization of the Rule provisions within Rule 3523 (c) while maintaining the overall protection originally intended by the Rule. Given the rationale previously stated, we believe a standard transition period is more appropriate than multiple rules to address different situations. The potential impact on independence is not different and a similar approach simplifies the application of the Rule in otherwise complex situations.

We would be pleased to provide the Board with additional information on the matters and our views as addressed by this letter.

Respectfully submitted,

Ernst & Young LLP