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Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, DC 20006

Subject: PCAOB Rulemaking Docket Matter No. 017

The California Board of Accountancy (CBA) commends the PCAOB for its effort to establish additional guidelines that are designed to ensure the independence of auditors of public companies. We are pleased to have the opportunity to respond to these proposed ethics and independence rules concerning independence, tax services, and contingent fees. For convenience, our comments will refer to the page numbers of PCAOB Release No. 2004-015.

General Comment. (Page 17, Para. 1)

“The Board invites comment on this discussion. In particular, the Board seeks comment on whether any of the types of services discussed in this section of the release raise independence concerns the Board has not identified. The Board also seeks comment on whether there are other types of tax services that could appropriately be included in this discussion.”

Representation of an audit client in tax audit and/or appeal proceedings where the auditor becomes an advocate for the client is a type of service not included in the Release discussion. Providing this type of service could raise independence issues (client advocacy functions) and the CBA believes this area should be considered for discussion.

Rule 3502. Responsibility Not to Cause Violations. (Page 19, Para. 2)

“The Board invites comments on any aspect of proposed Rule 3502 and encourages commenters to consider certain issues in particular. First, are there categories of circumstances encompassed by the rule as proposed that should not be encompassed by the rule for some reason? Second, in a circumstance in which a firm is found to have committed a violation that requires that the firm knowingly or recklessly engaged in the misconduct, would it be appropriate to find a Rule 3502 violation by an associated person who negligently contributed to the violation?”

The CBA agrees that both individuals (associated persons) and firms have a responsibility to know and follow professional standards and laws applicable to the practice of public accountancy. The CBA supports the position advanced in proposed

Rule 3502 that both associated persons as well as registered firms have a responsibility to comply with the Sarbanes-Oxley Act.

We have not identified categories of circumstances in the rule as proposed that we would recommend for deletion.

Rule 3520. Auditor Independence. (Page 20, Para. 4)

“The Board invites comments on any aspect of proposed Rule 3520, and encourages commenters to consider one issue in particular. Would the scope of the ethical obligation described above impose any practical difficulties? Commenters who foresee any such difficulties are encouraged to describe in detail any ways in which the proposed scope of the rule would cause or require auditors to follow any different practices and procedures than they currently follow to comply with existing legal requirements.”

The CBA supports the adoption of proposed Rule 3520 and endorses the PCAOB’s comment that rules of good conduct for auditors can and should encompass a duty by the auditor to maintain independence necessary to ensure compliance with independence requirements in the circumstances of the particular engagement.

At present, the CBA has not identified any practical difficulty issues were identified within the scope of ethical obligations as proposed in Rule 3520.

Rule 3521. Contingent Fees. (Page 23, Para. 1)

...The Board invites comment as to whether there are courts or other public authorities that fix fees that are not dependent on a finding or result, other than bankruptcy courts, such that the term "courts or other public authorities" is necessary.”

The CBA is not aware of any courts or other public authorities that fix fees that are not dependent on a finding or result, other than bankruptcy courts, such that the term “courts or public authorities” is necessary.

Rule 3522(a). Tax Transactions – Listed Transactions. (Page 29, Para. 2)

“Although the proposed rule does not address situations in which a transaction planned, or opined on, by the auditor becomes listed after it is executed, the Board seeks comment on whether the rule should address the possible impairment of an auditor's independence in such situations. The Board also seeks comment, more generally, on whether proposed Rule 3522(a) adequately describes a class of transactions that carry an unacceptable risk of impairing an auditor's independence.”

The CBA urges the PCAOB to consider expanding Rule 3522(a) to address situations in which a transaction becomes listed after it is executed, including the possible

impairment of an auditor's independence in such situations. A transaction that becomes listed before or shortly after the audit report is released would be particularly significant and further guidance would be useful.

Proposed Rule 3522(a) adequately describes a class of transactions that carry an unacceptable risk of impairing an auditor's independence.

Rule 3522(b). Tax Transactions – Confidential Transactions. (Page 31, Para. 1)

"The Board seeks comment on whether confidential transactions should be treated as per se impairments of a registered public accounting firm's independence from an audit client. More broadly, the Board also seeks comment on whether other provisions of the Treasury's regulation on reportable transactions – that is, other than the provisions on listed and confidential transactions included here – should be incorporated by reference in the Board's rules on tax-oriented transactions that impair independence."

CBA agrees that confidential transactions should be treated as per se impairments of a registered public accounting firm's independence from an audit client.

The CBA is not aware of any provisions of the Treasury regulations on reportable transactions that should be incorporated by reference in the Board's proposed rules on tax-oriented transactions that impair independence.

Rule 3522(c). Tax Transactions – Aggressive Tax Positions. (Page 34, √ 70)

70/ Cf. 26 C.F.R. § 1.6664-4(f)(2)(i)(B)(1) (incorporating by reference methodology set forth in 26 C.F.R. 1.6662-4(d)(3)(ii) for analysis of whether a tax treatment has "substantial authority" or, in the case of tax shelters, is "more likely than not" the proper treatment, for purposes of determining whether a penalty may be due on a substantial understatement of income tax). *The Board seeks comment on whether the analysis described in the Treasury's regulations provides useful guidance on the application of proposed Rule 3522(c).*

The CBA believes the analysis described in the referenced Treasury regulations does provide useful guidance.

Rule 3522(c). Tax Transactions – Aggressive Tax Positions. (Page 35, Para. 2)

"The Board invites comments on any aspect of proposed Rule 3522(c) and encourages commenters to consider certain issues in particular. First, is the term "initially recommended by the registered public accounting firm or another tax advisor" sufficiently clear? Is there a better way to describe aggressive tax transactions, strategies, and products that a registered public accounting firm ought not to sell to an audit client? Second, does the "more likely than not" standard draw the right line between aggressive tax strategies and products that

a registered public accounting firm ought not to plan, or opine on the tax treatment of, for an audit client and routine tax planning and advice? In addition, the Board invites comments on whether the Board also should require a registered public accounting firm to obtain a third-party tax opinion in support of the tax treatment, if the potential effect of the treatment could have a material effect on the audit client's financial statements."

The description for "aggressive tax positions" offered in Rule 3522(c) appears sufficient. However, the CBA believes that the independence of a registered public accounting firm is compromised where such public accounting firm initially recommends a transaction having tax avoidance as a significant purpose. Moreover, while such accounting firm should not be able to overcome the impairment by rendering its own opinion on its own tax plan, a third party opinion on such tax treatment could satisfy the impairment problem.

In other circumstances, where the transaction was not initially recommended by the registered accounting firm, the firm may independently choose to obtain a third party opinion though ultimate responsibility for the tax treatment of the transaction remains with the accounting firm.

The "more likely than not" standard is a reasonable measurement standard for this proposed rule due to its historical use in the regulations of the IRS and the Treasury.

General Comment Regarding Rule 3522.

Each of the three "transactions/tax positions" listed under (a), (b) and (c) of Proposed Rule 3522 are standards and definitions that uniquely apply under the US Internal Revenue Code.

They readily apply to US-based tax treatment and transactions and provide the accounting firm and audit committee appropriate guidelines in determining whether a proposed US tax service is a permissible non-audit service.

The proposed rule is silent with respect to any definition or rationale when tax laws in foreign jurisdictions are applicable to foreign-based transactions and related tax service is to be rendered to a foreign subsidiary or affiliate of a US audit client.

The CBA recommends that the PCAOB give consideration to this issue.

Rule 3523. Tax Services for Senior Officers of Audit Client. (Page 37, Para. 2)

"The Board invites comments on any aspect of proposed Rule 3523 and encourages commenters to consider certain issues in particular. Are there other classes of employees to whom an accounting firm should not offer tax services? Would a registered public accounting firm's independence be perceived to be

impaired if it offered tax services to members of an audit client's audit committee, or to other members of the audit client's board of directors?"

The CBA concurs that there should be a restriction on the tax preparation services that a registered public accounting firm may offer to individuals in roles that may influence the financial reporting process for the audit client.

We do believe that the registered public accounting firm's independence would be perceived to be impaired if it offered tax services to members of the audit client's audit committee or other members of the audit client's board of directors.

Rule 3524. Audit Committee Pre-approval of Certain Tax Services. (Page 42, Para.4)

"The Board welcomes comment on any aspect of proposed Rule 3524 and encourages comment on certain matters in particular. Should additional information or documentation that is not described in proposed Rule 3524 be provided to audit committees in the pre-approval process? In addition to the communications required by proposed Rule 3524, should auditors be required to have additional communications with the audit committee with regard to the tax advice that has been provided to the audit client?"

The CBA concurs that the Proposed Rule 3524 would strengthen the auditor's responsibilities in seeking the audit committee's pre-approval of tax services. The process and documentation suggested appear appropriate and reasonable.

In addition to the communications required by proposed Rule 3524, auditors should be required to have additional communications with the audit committee with regard to tax advice that has been provided in situations where there has been a material change in facts, circumstances, or scope of tax services provided. An example would be that a transaction becomes listed after it is executed.

Thank you for the opportunity to express our views. Should you have questions or need additional information, please contact Carol Sigmann, Executive Officer, at (916) 561-1718.

Sincerely,



Renata M. Sos
President

c: Members, California Board of Accountancy