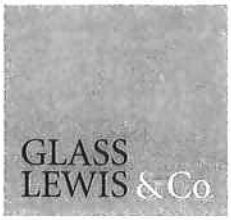


January 31, 2005

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. 017

Dear Sirs:

The Public Companies Accounting Oversight Board (PCAOB) is to be commended for proposing rules to promote the ethics and independence of registered public accounting firms. Glass Lewis applauds and supports the efforts of the PCAOB to strengthen the independence and improve the ethical conduct of independent auditors.

Summary

In summary, we believe:

- Auditors should be able to provide tax compliance services (i.e., the preparation of tax returns), but only if the audit committee with all the relevant facts has pre-approved the services, finding they are in the best interests of shareholders, and have disclosed that finding in filings with the Securities and Exchange Commission (SEC).
- In pre-approving all non-audit services provided by an independent accountant, the audit committee should have all the relevant facts including the terms of the engagement as set forth in the engagement letter. Otherwise, we fail to see how an audit committee can make a finding consistent with the SEC's rules which set a standard of "...a reasonable investor with knowledge of all relevant facts and circumstances..."[1]
- An auditor should not provide tax planning including tax opinions, structuring, shelter or expatriate type services to a company they audit, as they result in an auditor auditing their own work, acting as an advocate, or engaging in

[1] Regulation S-X, Article 210.2-01(b) which states: "The Commission will not recognize an accountant as independent, with respect to an audit client, if the accountant is not, or a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the accountant is not, capable of exercising objective and impartial judgment on all issues encompassed within the accountant's engagement. In determining whether an accountant is independent, the Commission will consider all relevant circumstances, including all relationships between the accountant and the audit client, and not just those relating to reports filed with the Commission."

questionable ethical conduct. An auditor should not provide a tax opinion on tax issues that subsequently must be examined by the independent auditor in connection with an examination of the financial statements. In situations such as expatriate tax work, we believe the service does not contribute at all to the quality of an audit but results in sizable contracts that may not be in the best interest of investors and raise questions about the impact of those fees on the independence of the auditor.

- An auditor should not provide services to Section 16(b) officers or members of the audit committee. These services put the auditor into the conflicted position of having to serve the interests of those individual officers that, at times, may conflict with those of investors.
- We concur that an auditor should be prohibited from entering into contingent fee or commission arrangements with a company they audit. We support the clarifying language the PCAOB is proposing.
- We believe the SEC's definitions of key terms, such as an affiliate of an accounting firm, should be adopted by the PCAOB and not "watered down."

Accurate financial information is necessary in order for investors to make reasonably informed decisions and for the orderly functioning of the U.S. capital markets. Independent auditors play a key role as the "gatekeepers" for this information. In that public interest role, auditors are to make an independent and unbiased examination of a company's financial statements and render an opinion as to whether they fairly present the results of operations, cash flows and financial condition of the company. This vital role allows investors to have confidence in the financial information they receive, and enhance their ability to make informed investment decisions, with confidence in the company, its management and its numbers. We note that in the opinion of the U.S. Supreme Court in 1984 in the matter of United States vs. Arthur Young, the court held the auditor owes its ultimate allegiance to the corporation's creditors and stockholders as they fulfill their "public watchdog" role.

Unfortunately, the role undertaken by accounting firms and some individuals in promoting abusive tax shelters to companies or executives of those companies, such as Qwest, Sprint and Enron, contribute to concerns investors have with respect to a lack of objective and independent auditor judgment. The troubling record exposed by congressional investigations and hearings provide a clear cut need for the PCAOB to address the shortcomings in the ethical conduct of individuals and firms within the accounting profession.[2] We also are aware that auditing firms continued to provide tax services in exchange for contingent fees, despite new rules adopted by the Securities and Exchange Commission (SEC) in 2000 prohibiting such arrangements. The Chief Accountant of the SEC's 2004 communication, which repeated the position set forth

---

[2] *U.S. Tax Shelter Industry: The Role of Accountants, Lawyers and Financial Professionals. Four KPMG Case Studies: FLIP, OPIS, BLIPS, AND SC2.* Report Prepared by the Minority Staff of the Permanent Subcommittee on Investigations of the Committee on Governmental Affairs, United States Senate. 2003.

SEC's rulemaking process in 2000, gives rise to further concerns regarding the ethics of the firms and their commitment to the highest level of ethical conduct. Accordingly, it is important the PCAOB enacts rules to permit it to take timely, appropriate actions with respect to those who fail to comply with both the intent and letter of the law when it comes to ethics and independence in the accounting profession.

International tax matters, including expatriate tax services have also resulted in disciplinary actions in the profession. The recent six-month suspension Ernst &Young received from the SEC was a direct result of expatriate tax services. The judge's opinion noted (1) EY's International Tax Group had an Application Software partnership with PeopleSoft for EY/GEMS for PeopleSoft, and (2) EY was a PeopleSoft customer and used PeopleSoft's HRMS Payroll and Financials for its internal operations. The release also notes EY's business relationships with PeopleSoft concerning software developed by its Tax Group and its consulting activities were at issue.[3]

Glass, Lewis & Co., LLC

Glass, Lewis & Co., LLC is an independent proxy and financial research firm that provides research to institutional investors and other users of financial statements of public companies. In that regard, we rely on audited financial statements and disclosures that public companies provide to investors, regulators and the capital markets. Our staff has many years of experience as financial analysts, auditors, chief financial and accounting officers, preparers of financial statements and securities counsel. Two of our staff also serve as chair of audit committees of public companies. From our perspective, it is vitally important to investors and the capital markets, that the registered public accounting firms and individuals within those firms, exercise unbiased, neutral and independent judgment. Without confidence that such judgments are made, investors are likely to lose faith in the financial statements they receive, as occurred in 2001 to 2002 when the U.S. capital markets lost trillions in value.

General Comments

The report of the Conference Board Commission on Public Trust and Private Enterprise, Co-Chaired by former U.S. Secretary of Commerce, Peter Peterson and John Snow, current U.S. Treasury Secretary, states:

> "Public Accounting firms should limit their services to their clients to performing audits and to providing closely related services that do not put the auditor in an advocacy position, such as novel and debatable tax strategies and products that involve income tax shelters and extensive off-

[3] INITIAL DECISION RELEASE NO. 249, ADMINISTRATIVE PROCEEDING FILE NO. 3-10933, In the Matter of Ernst & Young LLP. Initial Decision of April 16, 2004. See section titled "EY's Global Expatriate Management System for PeopleSoft." Available at: http://www.sec.gov/litigation/aljdec/id249bpm.htm

> shore partnerships or affiliates...Public accounting firms are permitted to perform certain tax services for their clients. The Commission believes that any work performed by the company's outside auditors be closely related to the audit. Auditors' development and recommendations of new tax strategies for their clients is not closely related to the audit and, in our opinion, removes focus from their audit work and poses a potential conflict of interest. Furthermore, the development and recommendations of these tax strategies have often been accompanied by "success fees." In turn, these strategies, if implemented, were often then subject to an audit by the firm. This practice, in our opinion, is highly undesirable...
>
> The Commission does not believe that there is a conflict of interest in a public accounting firm providing certain income tax and other services, such as preparing tax returns for corporations, provided that these services do not place the auditor in the roles of acting as an advocate for the company."[4]

We are concerned registered public accounting firms have designed, promoted and sold tax products and/or services whose only purpose was to evade or get around tax laws, rules and regulations on a federal, state and local level. It is hard to understand how a reasonable investor would believe such behavior is ethical for a firm of public accountants who have been entrusted by Congress with a public franchise built on trust.

The principles of the Code of Professional Conduct of the American Institute of Certified Public Accounts (AICPA) "call for an unswerving commitment to honorable behavior, even at the sacrifice of personal advantage."[5] Article III of the Code states:

> "01. Integrity is an element of character fundamental to professional recognition. It is the quality from which the public trust derives and the benchmark against which a member must ultimately test all decisions.
>
> 02. Integrity requires a member to be, among other things, honest and candid within the constraints of client confidentiality. Service and the public trust should not be subordinated to personal gain and advantage. Integrity can accommodate the inadvertent error and the honest difference of opinion; it cannot accommodate deceit or subordination of principle.
>
> 03. Integrity is measured in terms of what is right and just. In the absence of specific rules, standards or guidance, or in the face of conflicting

---

[4] *Report of the Commission on Public Trust and Private Enterprise.* The Conference Board.2003. Page 41.
[5] *Principles of Professional Conduct.* ET Section 51. AICPA. 2004.

opinions, a member should test decisions and deeds by asking: "Am I doing what a person of integrity would do?..."

04. Integrity also requires a member to observe the principles of objectivity and independence and of due care."[6]

We do not believe an accounting firm providing a product or service, whose purpose is to circumvent the tax laws, rules and regulations of this country, meets the above principles of conduct that have long been established for the public accounting profession. We believe such services violate the ethics the profession has established for itself. Accordingly, while we support the proposed rules of the PCOAB in this matter, we also believe it is equally important the PCAOB undertake to consider ethical guidelines that prohibit such conduct by registered public accounting firms.

We believe when an accounting firm provides tax planning or strategy advice, the firm's independence is impaired as a result of the auditor subsequently having to audit and reach an unbiased and objective opinion on the advice the firm has previously rendered. An example of this is when a firm develops or assists a company in developing an international tax and inter-company pricing strategy. We believe such services put the auditor in the awkward position of challenging the work and findings of his firm, possibly exposing the firm to litigation. We also believe such services are inconsistent with the recommendations of the Commission on Public Trust.

Yet, we are also mindful Congress and the SEC has left the broader issues regarding tax compliance services to the judgment of the audit committee and/or PCAOB. Accordingly, we believe the PCAOB should take an approach to a tax service that is somewhat similar to one of the views discussed in the report of the Panel on Audit Effectiveness.[7] We believe that tax compliance services should be permitted but only if (1) the audit committee pre-approved such services, (2) found those services to be in the best interest of the shareholders, and (3) provided disclosure of that finding to investors in the annual proxy to shareholders.

Rule 3501. Definitions of Terms Employed in Section 3, Part 5 of the Rules.

We agree with the board that it should clearly define key terms such as "Affiliate of the Accounting Firm" and "Affiliate of the Audit Client." During the SEC's rulemaking efforts in 2000, there was agreement between the SEC and the profession on terms such as "Affiliate of the Audit Client", "Investment Company Complex," "Audit and Professional Engagement Period", and "Audit Client." Accordingly, we believe the

---

[6] Ibid, ET Section 54. AICPA. 2004

[7] *The Panel on Audit Effectiveness, Report and Recommendations.* AICPA. August 31, 2000. Page 119, paragraph 5.38.

PCAOB should adopt the definitions used in the rules of the SEC for these terms, so as to avoid differences that could contribute to confusion among auditors.

In the past half dozen years, improper recognition of revenue has been the leading cause of restated financial statements. The vice president responsible for sales is perhaps the most critical person with an oversight role related to this function. Individuals in this role have been involved in a number of frauds cited in SEC enforcement actions. If an effective audit is to be achieved, the audit engagement teams, including the engagement partner are going to have to interact with this person. Accordingly, in light of the prevailing evidence regarding problems with revenue recognition, we believe that the vice president of sales should be incorporated into the definition of financial reporting oversight role. In turn, we believe an audit firm should not provide tax services to this individual.

The definition of contingent fees in proposed rule 3501(c)(i) is appropriate and an improvement on the prior definition of the SEC. We strongly concur with deleting the language from the previous SEC rule regarding tax services subject to governmental findings or judicial proceedings. This language, which was clarified in the SEC adopting release, resulted in registered firms continuing to enter into inappropriate contingent fee arrangements and should be deleted. We also support removing the language in the proposed definition referring to "other public" authorities as the proposing release is unclear as to who such a party might be.

Rule 3502. Responsibility Not to Cause Violations.

We understand this rule would establish the PCAOB'S authority to take action against an individual who violated the independence rules of the PCAOB or SEC as well as the securities laws. We strongly believe the PCAOB should take action against an individual who causes a firm to violate the applicable laws and rules. Accordingly, we support the PCAOB adoption of this rule. We also believe the PCAOB should have the ability to take action against a firm when its lack of quality controls indicates a systemic breakdown in the firm. For example, the PCAOB should have the power to take actions such as those taken by the SEC in recent years against E&Y in the PeopleSoft matter and PricewaterhouseCoopers.

Rule 3520. Auditor Independence.

We agree with this proposed rule requiring the auditor of a company to be independent throughout the audit and professional engagement period. This should be consistent with the similar rule of the SEC.

We believe the four basic principles for auditor's independence that are set forth in the preliminary note to SEC Regulation 210.2-01, and which served as the foundation for the prohibited services set forth in SOX, should be encapsulated into this rule. These

principles include whether a relationship or service (a) creates a mutual or conflicting interest between the accountant and the audit client, (b) places the accountant in the position of auditing his or her own work, (c) results in the accountant acting as management or an employee of the audit client, or (d) places the accountant in a position of being an advocate for the audit client. We would also incorporate into the rule the language from the AICPA's code of conduct which states that an auditor should avoid any subordination of their judgment.[8]

Rule 3521. Contingent Fees.

An auditor should not be permitted to provide services or products for contingent fees or commissions. Such fees should not be permitted either through direct or indirect payments. Contingent fees were cited in a July 2002 SEC enforcement action against PricewaterhouseCoopers. We are also aware of situations where auditors proposed providing tax services in exchange for a fee plus a percentage of any reduction in taxes generated by the auditor. When an auditor has such a mutual interest with the company in a key number in the financial statements, such as the income tax liability and expense, we do not believe an auditor can exercise unbiased judgment. We also do not believe a reasonable investor, with knowledge of all the facts (which unfortunately they are unable to get in such situations), would ever perceive the auditor as being independent. Accordingly, we believe an auditor is not independent when services are provided for contingent fees or commissions.

We are alarmed the profession, notwithstanding the language in the SEC's adopting release in 2000, has evaded the SEC's written rule. Accordingly, we believe it is important the PCAOB adopt this rule so as to provide it with the necessary tool to take action were such behavior to continue.

Rule 3522. Tax Transactions.

First, as background, fees paid to auditors for tax services as a percentage of audit fees decreased among the Fortune 500 companies from 57% in 2002 to 43% in 2003, the last year current data is available. In fact, 126 or over 25% of the companies paid their auditors nothing or less than 10% of their audit fees for tax services work in 2003. Yet 43 companies paid their auditor tax fees that exceeded the amount of audit fees for 2003. A survey of 1805 non Fortune 500 companies found fees paid to auditors for tax work decreased from 47% in 2002 to 38% in 2003. Among these companies, 568 or more than 33% paid their auditors nothing or less than 10% of their audit fees, while 466 had done so in 2002. In fact, the evidence clearly demonstrates many companies have an internal tax department that performs the necessary tax work or an accounting firm, other than the

[8] *Principles of Professional Conduct.* ET Section 55. AICPA. Paragraph .02 states: "Regardless of service or capacity, members should protect the integrity of their work, maintain objectivity, and avoid any subordination of their judgment."

auditor, is retained to perform these services. We are not aware of any indications from the auditors or companies they audit, where the auditor is not engaged for tax services, or engaged for only minimal services, that there are substandard audits being performed. As a result, the argument often put forth that the auditor performing tax services is necessary for a quality audit, are not born out by the facts.

We believe a simpler approach to tax services is the one we have previously described in the summary above. In addition, we believe there are certain tax services such as the preparation of expatriate tax returns, tax planning and providing tax opinions that do not enhance the quality of the audit or the independence of the registered public accounting firm. For example, we note that if the criteria for evaluating the independence of an auditor, set forth in the Panel on Audit Effectiveness and the Financial Reporting Codification of the SEC are applied to expatriate tax work, such work would not be approved.[9] This is in part because such tax work does not contribute to the audit or knowledge of the auditors in any meaningful way. However, such engagements do usually result in fees that may approach or exceed the amount of audit fees. A survey of financial analysts by the American Institute of Investment Management (AIMR – now the CFA Institute) in 2000 noted that non-audit fees that exceeded 50 percent of audit fees caused a majority of the analysts to conclude an auditor's independence was impaired.

We are also concerned given recent disclosures (or the lack thereof) indicating the major accounting firms are continuing to provide prohibited services in connection with foreign expatriate services or prohibited services for certain foreign affiliates of international companies that a firm audits. The proposing release states the Board has "not identified independence or ethical issues when an accounting firm provides these routine tax return preparation services to its audit clients..." However, we understand the Board is fully aware of related services the major accounting firms have provided that do clearly violate the independence rules, including the types of bookkeeping and tax payment services firms often provide when doing expatriate tax return work. Clearly, this has become a problem for the profession. We are also aware one Big Four firm and many of the affected companies it audits, have taken the high road and made disclosure of such violations of the independence rules. However, we also understand other auditing firms are advising the companies they audit not to disclose such violations. Such behavior is unethical and one would be hard pressed to understand how it serves investors and meets the principles of the profession's code of conduct. Furthermore, this creates a serious un-level playing field for the one firm that has exhibited the appropriate behavior. We would urge the PCAOB and SEC to quickly level the playing field and ensure investors receive information necessary to make informed judgments when voting proxy issues involving the selection of auditors. We find it concerning regulators would willingly accede to nondisclosure of known violations of SEC regulations, without taking action to

---

[9] *Audit Committees and Independence*. Codification of Financial Reporting Policies. Section 601.03. Securities and Exchange Commission.

ensure investors are provided information regarding those violations. If auditors continue to advocate a lack of transparency, one can only question their motives for doing so.

However, should the PCOAB decide to continue with the rule as proposed, we would recommend the Board include a mechanism designed to deal with changes that might be incorporated in the tax code or regulations with respect to listed, confidential or tax avoidance transactions at a later date. We do not believe the PCOAB's rules should be automatically modified without public comment, due to a change in the rules of the Treasury Department or Internal Revenue Service. Accordingly, we believe the applicable language, as it exists today in the Code of Federal Regulations, Title 26, Sections 1.6011-4 and 1.6662-4(g) should be incorporated into the final PCAOB rule.

We also believe the language in the rule should be modified to clarify it includes prohibited tax services provided either in the U.S. or abroad. A recent article in the Wall Street Journal noted that a European court has also given tax shelters in foreign jurisdictions a negative review as well.[10] Accordingly, to clarify that the equivalent of listed or confidential transactions in foreign jurisdictions are also covered by the proposed rules, we believe Rule 3522 should be modified by add the language "or its equivalent" at the end of both paragraph 3522(a) and (b).

The proposed rule would also allow an auditor to provide a tax opinion on an aggressive tax position, so long as the company first obtained advice on that transaction from another firm. This would permit a company to seek advice from another firm, and then obtain a tax opinion from their auditor on the tax position. We believe an auditor's independence is impaired when it issues a tax opinion on a transaction, and that transaction is subject to examination in the audit, regardless of who proposed or initially recommended the aggressive tax position. Accordingly, we believe the language in 3522(c) should be modified to eliminate the word "initially." Allowing another firm to provide an opinion would be an easy loophole to avoid violations without changing current practices.

Rule 3523. Tax Services for Senior Officers of Audit Client.

We believe an auditor's independence is impaired when they are providing tax services to senior officers of an audit client, as well as those on the Board of Directors in an oversight role. We are aware of at least one major accounting firm who has indicated it would not provide tax services to Section 16(b) officers and directors without first receiving the pre-approval of the audit committee.

Accordingly, we believe the Board should expand its proposal to prohibit tax services being provided to at least the members of the audit committee of the board of directors.

---

[10] *European Court Gives Tax Shelter Negative Review.* Wall Street Journal. January 28, 2005.

The PCAOB has acknowledged in its Auditing Standard No. 2, the key role the audit committee plays in the oversight of the finance and auditing functions.[11] Given the audit committee hires, evaluates and when necessary fires the auditor, we have a difficult time understanding any basis the Board might have for not including the audit committee in the prohibition while including others with perhaps lesser roles.

We also note with growing concern the business relationships auditors have entered into with members of Boards of Directors. The recent disclosures surrounding such relationships at Best Buy and TIAA-CREF indicate a weakness in the quality controls of accounting firms in identifying inappropriate business relationships, such as were identified in these situations. We believe a member of an audit committee receiving payments from the auditors is an inherent conflict that results in a lack of independence. This would include situations where the audit committee member serves as an expert witness and/or advocate for the auditor. Accordingly, we recommend the PCOAB's final rule prohibit not only the auditor from providing tax services to members of the audit committee, but also from entering into business relationships, financial interests and mutuality of interests between the auditor and committee member. We also believe an auditor should be required to disclose in writing to the full audit committee any relationships between a member of the audit committee and the auditor.

Rule 3524. Audit Committee Pre-Approval of Certain Tax Services.

We strongly support the PCAOB proposal with respect to audit committee pre-approval of certain tax services. Congress, while choosing not to tackle the politically sensitive issue of auditors providing certain tax services, did chose to rely on audit committees for making judgments regarding whether non-audit services would impair the independence of the auditor.

We understand accounting firms have already expressed concerns with this part of the PCOAB proposal. However, we find it entirely consistent with the guidance in the Taub memo referenced in the proposing release. We note that prior to this memo, accounting firms advocated providing information to audit committees that would have failed to provide them with sufficient detail to make informed decisions.[12] Given the previous behavior of the accounting firms regarding audit committee pre-approval, we believe the

---

[11] *An Audit of Internal Control Over Financial Reporting Performed in Conjunction with An Audit of Financial Statements*, Auditing Standard No. 2. PCAOB. 2004. Paragraph 55 states: "The company's audit committee plays an important role within the control environment and monitoring components of internal control over financial reporting." Paragraph 59 states: "Ineffective oversight by the audit committee…should be regarded as at least a significant deficiency and is a strong indicator that a material weakness in internal control over financial reporting exists."

[12] See the letter to SEC Chairman William Donaldson dated June 5, 2003, from the Consumer Federation of America, Consumers Union, Consumers Union, Consumer@ction and U.S. Public Interest Research Group.

PCOAB's proposal is warranted and necessary to ensuring audit committees fulfill their mandate under the Sarbanes-Oxley Act of 2002 and applicable SEC regulations.

In particular, we believe the best way to ensure audit committees fulfill their responsibility is to ensure they are provided copies of the engagement letter that includes descriptions of the scope of any tax service under review and the fee structure for the engagement. We understand that such letters were not commonly provided to audit committees in the past, including when such letters included inappropriate contingent fees that audit committee members may have found troublesome. Accordingly, audit committee members were unable to exercise judgment on these matters and may have even been "in the dark" with respect to them.

We are also aware some independence violations that have occurred were not listed or even mentioned in letters registered public accounting firms are required to provide to the audit committee, commonly referred to as the ISB No. 1 letter. ISB Standard No. 1 requires each auditor to disclose in writing to its client's audit committee all relationships between the auditor and the company that, in the auditor's judgment, reasonably may be thought to bear on independence. The auditor and audit committee are also required to discuss the auditor's independence. As the SEC has clarified its perspective on the ISB No. 1 letter in its adopting release in 2000 concerning auditor's independence, we again must question the motives of firms who have failed to make this disclosure to the audit committees.[13] We believe the lack of transparency in ISB No. 1 letters unequivocally indicates the need for audit committees to obtain and understand the engagement letters.

We have heard some in the profession express the view that this will mean the audit committees will need to review an extensive number of engagement letters. Our experience as both auditors and members of audit committees does not support that view.

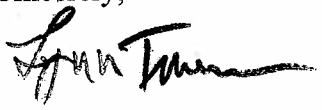
---

[13] See Revision of the Commission's Auditor Independence Requirements, Securities and Exchange Commission. November 2004. The release states:

> "In a letter to the SECPS, ISB Chairman William Allen clarified the use of the auditor's judgment under the standard. He stated:
>
> [I]n asking itself whether a fact or relationship is material in this setting the auditor may not rely on its professional judgment that such fact or relationship does not constitute an impairment of independence. Rather the auditor is to ask, in its informed good faith view, whether the members of the audit committee who represent reasonable investors, would regard the fact in question as bearing upon the board's judgment of auditor independence.
>
> Letter from William T. Allen, Chairman, ISB, to Michael A. Conway, Chairman, Executive Committee, SECPS (Feb. 8, 1999). We believe that Chairman Allen's interpretation is appropriate."

Our responses to the specific questions the Board has asked for comment on are attached hereto as Appendix A. We would be pleased to discuss our responses with the Board and/or its staff.

Sincerely,



Lynn E. Turner
Managing Director of Research

cc: Mr. Donald Nicholiasen – Chief Accountant, Securities and Exchange Commission

Appendix A

Responses to Questions

Question on Pages 16 and 17. Provision of Routine Tax Return Preparation and Tax Compliance, General Tax Planning and Advice, International Tax Services and Employee Tax Services.

Like international assignment tax services, registered firms' provision of personal tax services for employees of their audit clients has not raised significant independence concerns, except for personal tax services for officers who function in a financial reporting oversight role at the audit client. Accordingly, the Board's proposed rules to restrict auditors from providing personal tax services to audit client employees are limited to those officers who serve in a financial reporting oversight role.

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.

Response:

Tax services such as developing international tax strategies, international inter-company pricing agreements, result in an auditor having to audit their own work. Accordingly, we believe such services should be prohibited. In addition, we do not believe expatriate tax return work, which has recently resulted in violations of existing SEC independence rules by international accounting firms, contribute in any meaningful way to the quality of the audit. Often these expatriate employees become Section 16(b) officers and, as a result, ultimately result in a conflict for the accounting firm, the employee and the company. Accordingly, we do not believe such services should be permitted.

Question on Page 19. Proposed Rule 3502 Regarding Responsibility Not to Cause Violations.

As discussed in Section B1, Rule 3520 requires registered firms to be independent of their audit clients. When an associated person negligently causes the registered firm to not be independent, Rule 3502 would allow the Board to discipline that associated person for that action.

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?

Response:

There should be a finding against an individual in a case where it is found a firm knowingly or recklessly engaged in misconduct. We note that disregard of the SEC independence rules is considered a violation that can result in a Rule 102(e) sanction by the Commission.

We do not believe any actions should be exempted from the proposed rule at this time.

Question on Page 20. Proposed Rule 3520 Regarding Fundamental Ethical Obligation of Registered Public Accounting Firm to be Independent Throughout the Audit and Professional Engagement Period.

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.

Response:

We believe the proposed rule is consistent with the SEC rule adopted in November 2000 which became effective in 2001. Accordingly, provided a registered public accounting firm and its staff have complied with the rules of the SEC, there should not be any practical difficulties in implementing the rule proposed by the PCAOB.

Question on Page 23. Contingent Fees

Accordingly, the exception would permit fees that are contingent on "the amount [being] fixed by courts or other public authorities and not dependent on a finding or result."[14] Although the approval of a bankruptcy court is the most obvious contingency that may be imposed on auditors' fees from audit clients, the proposed exception extends to other

---

[14] Proposed Rule 3501(c)(i)(2).

"courts or other public authorities." 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.

Response:

We are not aware of "other public authorities" that would fall within the language of the proposed rule. Accordingly, if the PCOAB continues to use this language, which we believe should be deleted, we would urge it to clarify what other public authorities it is referring to so as to avoid further abuses by the profession.

Question on Page 29. Aggressive Tax Positions and Listed Transactions.

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.

Response:

We believe an auditor's independence would become impaired if a listed transaction it planned or advised on was listed subsequent to its advice or opinion. That is because we believe the independence is impaired, as it would be placed in the position of auditing its own work. Accordingly, we believe tax planning and strategy services, in addition to developing or marketing tax shelters, listed or confidential transactions should be prohibited to avoid unnecessary conflicts and complexity in the rules.

26 C.F.R. defines listed and confidential transactions as follows:

> "**(2) Listed transactions.** A listed transaction is a transaction that is the same as or substantially similar to one of the types of transactions that the Internal Revenue Service (IRS) has determined to be a tax avoidance transaction and identified by notice, regulation, or other form of published guidance as a listed transaction.
>
> **(3) Confidential transactions**--(i) In general. A confidential transaction is a transaction that is offered to a taxpayer under conditions of confidentiality and for which the taxpayer has paid an advisor a minimum fee. (ii) Conditions of confidentiality. A transaction is considered to be offered to a taxpayer under conditions of confidentiality if the advisor who is paid the minimum fee places a limitation on disclosure by the taxpayer of the tax treatment or tax structure of the transaction and the limitation on disclosure protects the confidentiality of that

advisor's tax strategies. A transaction is treated as confidential even if the conditions of confidentiality are not legally binding on the taxpayer. A claim that a transaction is proprietary or exclusive is not treated as a limitation on disclosure if the advisor confirms to the taxpayer that there is no limitation on disclosure of the tax treatment or tax structure of the transaction. (iii) Minimum fee. For purposes of this paragraph (b)(3), the minimum fee is: (A) $250,000 for a transaction if the taxpayer is a corporation. (B) $50,000 for all other transactions unless the taxpayer is a partnership or trust, all of the owners or beneficiaries of which are corporations (looking through any partners or beneficiaries that are themselves partnerships or trusts), in which case the minimum fee is $250,000. (iv) Determination of minimum fee. For purposes of this paragraph (b)(3), a minimum fee includes all fees for a tax strategy or for services for advice (whether or not tax advice) or for the implementation of a transaction. These fees include consideration in whatever form paid, whether in cash or in kind, for services to analyze the transaction (whether or not related to the tax consequences of the transaction), for services to implement the transaction, for services to document the transaction, and for services to prepare tax returns to the extent that the fees exceed the fees customary for return preparation. For purposes of this paragraph (b)(3), a taxpayer also is treated as paying fees to an advisor if the taxpayer knows or should know that the amount it pays will be paid indirectly to the advisor, such as through a referral fee or fee-sharing arrangement. A fee does not include amounts paid to a person, including an advisor, in that person's capacity as a party to the transaction. For example, a fee does not include reasonable charges for the use of capital or the sale or use of property."

We believe the minimum fee amount of $250,000 in the above regulations should be eliminated such that regardless of the fee amount, a listed transaction would be prohibited. We believe an auditor provided services in connection with a listed transaction, regardless of the fee amount, is inconsistent with an auditor being independent and also inconsistent with the ethical behavior expected of the auditor.

We believe the final rule should incorporate the following language in the 26 C.F.R 1.6662-4(g) including defining what constitutes a tax shelter:

"**(2) Tax shelter**--(i) In general. For purposes of section 6662(d), the term ``tax shelter'' means--

(A) A partnership or other entity (such as a corporation or trust),

(B) An investment plan or arrangement, or

(C) Any other plan or arrangement, if the principal purpose of the entity, plan or arrangement, based on objective evidence, is to avoid or evade Federal income tax. The principal purpose of an entity, plan or arrangement is to avoid or evade Federal income tax if that purpose exceeds any other purpose. Typical of tax shelters are transactions structured with little or no motive for the realization of economic gain, and transactions that utilize the mismatching of income and

deductions, overvalued assets or assets with values subject to substantial uncertainty, certain nonrecourse financing, financing techniques that do not conform to standard commercial business practices, or the mischaracterization of the substance of the transaction. The existence of economic substance does not of itself establish that a transaction is not a tax shelter if the transaction includes other characteristics that indicate it is a tax shelter.

(ii) Principal purpose. The principal purpose of an entity, plan or arrangement is not to avoid or evade Federal income tax if the entity, plan or arrangement has as its purpose the claiming of exclusions from income, accelerated deductions or other tax benefits in a manner consistent with the statute and Congressional purpose."

Question on Page 31. Confidential Tax Positions

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.

Response:

We note 26 C.F.R. 1.6011-4 includes six categories of transactions. These include (1) listed transactions, (2) confidential transactions, (3) transactions with contractual protection, (4) loss transactions, (5) transactions with significant book-tax differences and (6) transactions involving a brief asset holding period. A transactions with contractual protection is a transaction for which the taxpayer or a related party (as described in section 267(b) or 707(b)) has the right to a full or partial refund of fees (as described in paragraph (b)(4)(ii) of this section) if all or part of the intended tax consequences from the transaction are not sustained.

A transaction with contractual protection also is a transaction for which fees (as described in paragraph (b)(4)(ii) of this section) are contingent on the taxpayer's realization of tax benefits from the transaction. We believe transactions with contractual protection result in an auditor who has advised on such a transaction, and the company who has paid a fee for such services, as having a mutual interest, in addition to requiring the auditor to audit their own tax advice and work. Accordingly, such services should be specifically prohibited.

Question in Footnote 70 on page 34. Aggressive Tax Positions

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).

Response:

Regulations 1.6662-4(d) discusses substantial authority as follows:

> "The substantial authority standard is less stringent than the more likely than not standard (the standard that is met when there is a greater than 50-percent likelihood of the position being upheld), but more stringent than the reasonable basis standard as defined in Sec. 1.6662-3(b)(3). The possibility that a return will not be audited or, if audited, that an item will not be raised on audit, is not relevant in determining whether the substantial authority standard (or the reasonable basis standard) is satisfied."

We believe the appropriate standard to be applied to Listed, Confidential, Aggressive and Contractual protection transactions is the "more likely than not" standard rather than the less stringent "substantial authority" standard. We believe transactions that do not meet the "more likely than not" standard for prevailing with the taxing authorities and courts, result in the auditor having to advocate for a transaction they have advised or opined on when there is less than a 50 percent chance of prevailing. This creates a very significant conflict for an auditor as the applicable criteria for determining the proper accounting for an aggressive tax position in financial statements is considered by some firms to be the "probable" standard included in Statement of Financial Standard No. 5.

Question on Page 35. Aggressive Tax Positions

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.

Response:

As previously noted, we believe auditors should be prohibited from providing tax services other than tax compliance services. However, should the PCOAB determine to permit such services, we believe:

- The more likely than not standard is an appropriate standard.
- Clarify what is meant by "initially recommended."
- Prohibit an auditor from providing a tax opinion on a transaction the auditor must then examine in the course of the audit.

Question on Page 37. Rule 3523. Tax Services for Senior Officers of Audit Client

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?

Response:

As previously stated, we believe an auditor should not provide any services to the Section 16(b) officers, including any officers in a financial reporting oversight role and any directors on the audit committee. We also believe senior officers in a financial reporting oversight role should be expanded to include the officer with key responsibility for sales, a subject most often the cause of misstated financial statements.

Question on Pages 42 and 43. Rule 3524. Audit Committee Pre-approval of Certain Tax Services

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?

Response:

The SEC has defined the test for determining an auditor's independence as a reasonable investor with knowledge of all relevant facts and circumstances. The audit committee is the investors elected representative and, accordingly, is put in the position of assessing

whether an auditor's independence is impaired and, accordingly, should not provide pre-approval of services be pre-approved. In making that judgment, we believe the audit committee should be provided with all the relevant facts and circumstances. To meet that test, we believe it is imperative the audit committee obtain copies of the actual engagement letters. We believe the failure of auditors to disclose questionable circumstances to audit committees such as contingent fees support this requirement.