



280 Park Avenue
New York, NY 10017

Telephone 212 909 5400
Fax 212 909 5699

February 11, 2005

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

Dear Mr. Secretary:

**PCAOB Rulemaking Docket Matter No. 017:
Proposed Ethics and Independence Rules Concerning Independence,
Tax Services, and Contingent Fees**

On behalf of KPMG LLP (U.S.) and the other member firms of KPMG International worldwide, we are pleased to submit our comments on the Board's proposed ethics and independence rules. We commend the Board for developing the Proposed Rules that, in our view, are balanced and provide a needed level of clarity concerning what is, or is not, a permissible tax service. We welcome the opportunity to participate in strengthening auditor independence and serving the public interest.

As further explained in this letter, we support:

- the Proposed Rules on prohibiting auditors from providing tax services in connection with aggressive tax transactions;
- the Proposed Rules on prohibiting auditors from providing tax services to certain individuals in a financial reporting oversight role; and
- the Board's conclusion that providing routine tax return preparation and tax compliance, general tax planning and advice, international assignment tax services, and employee personal tax services does not compromise an auditor's independence, in fact or appearance.

We believe the rationale for the Proposed Rules on these matters, as expressed in the Release accompanying the Proposed Rules, is well reasoned and practicable.





Office of the Secretary
Public Company Accounting Oversight Board
February 11, 2005
Page 2

We believe the Board should reconsider:

- the language in Proposed Rule 3502 regarding the obligations of persons in a registered public accounting firm because we believe the language is vague and potentially unfair; and
- the requirements in Proposed Rule 3524 for auditors to provide the audit committee with engagement letters for each proposed tax service because (i) we believe audit committees can and do make appropriate decisions about the documentation they require from the audit firms to enable them to effectively pre-approve tax services, and (ii) in some instances the volume of engagement letters would be burdensome to audit committees.

In addition, there are issues relating to implementation of the Proposed Rules that either should be reconsidered or clarified in the Final Rules. In particular, the Proposed Rules would apply certain terminology and concepts found in the U.S. tax regulations to non-U.S. transactions. We encourage the Board to carefully consider the applications of its rules in non-U.S. settings. Where it is determined these terms and concepts should apply outside of the U.S., the Final Rules should clarify their application for non-U.S. auditors.

Our full comments on the Proposed Rules are presented on the following pages in the same sequence as the issues are presented in the Release.



Office of the Secretary
Public Company Accounting Oversight Board
February 11, 2005
Page 3

Responsibility Not to Cause Violations (Proposed Rule 3502)

We support the Board's aim to create a rule codifying the ethical obligation of all persons associated with registered public accounting firms "not to be a cause of any violations by the firm" of the Sarbanes-Oxley Act (the Act), the U.S. securities laws, or the rules of the Board. We believe, however, that the text of Proposed Rule 3502 would create problems of vagueness and fairness, regarding both the proper level of intent, and causation, for establishing violations of the Proposed Rule. Indeed, the Proposed Rule text comes from a provision of the Securities Exchange Act designed for a different purpose and, if ultimately adopted, could upset the calibrated scheme established by Congress under the Act. Given the highly technical and complex nature of the accounting profession's regulatory environment, we believe the Board should develop a simpler standard so auditors have fairer and clearer guidance. Such an approach will further the Board's own regulatory goals, and will benefit public companies and the wider community of investors.

Accordingly, we recommend that the Board adopt a more limited standard in accordance with the Board's authority and the sanction scheme established by the Act. Specifically, the last clause of Proposed Rule 3502 should read "due to an act or omission the person knew would cause such violation." This language properly respects the severity of the Board's disciplinary powers under the Act, reflects the complexities inherent in the application of the relevant rules and professional standards, and allows persons associated with a registered public accounting firm to better understand their obligations and any potential sanctions for their acts or omissions.

A more complete discussion of our views on Proposed Rule 3502 is included as Attachment I to this letter.

Auditor Independence (Proposed Rule 3520)

Proposed Rule 3520 effectively mirrors the current independence requirements of the accounting profession and the Securities and Exchange Commission (SEC). We agree that an accounting firm should meet this "fundamental ethical obligation" to be independent of its audit clients.

Contingent Fees (Proposed Rule 3521)

We agree with Proposed Rule 3521 which would prohibit contingent fees with SEC audit clients. However, we believe the discussion in footnote 45 in the Release may cause confusion surrounding the intended meaning of "audit and professional engagement period." Specifically, footnote 45 implies that the Board would modify the SEC's definition so that the professional engagement period could be understood to commence when a registered public accounting firm "signs or submits to the audit client" an engagement letter or begins audit procedures, whichever is earlier. This is different from the current SEC definition which starts such period when the auditor "signs an initial engagement letter" or begins procedures, whichever is earlier. We believe that in the



Office of the Secretary
Public Company Accounting Oversight Board
February 11, 2005
Page 4

Release accompanying the Final Rule, the Board's discussion of "audit and professional engagement period" should be conformed to the current definition in Regulation S-X §210.2-01(f)(5).

Tax Transactions (Proposed Rule 3522)

Proposed Rule 3522 would treat a registered public accounting firm as not independent of its audit client if the auditor provides any non-audit service to the audit client relating to planning, or opining on the tax treatment of, a "listed" or "confidential" transaction or an "aggressive tax position" (each as defined in the Proposed Rule). We generally agree with Proposed Rule 3522. However, as detailed below, we believe revisions are necessary in order to clarify certain terms and the application of Proposed Rule 3522, especially for non-U.S. transactions.

Listed Transactions (Proposed Rule 3522(a))

Proposed Rule 3522(a) would treat a registered public accounting firm as not independent of its audit client if the firm provides services related to planning, or opining on the tax treatment of, a "listed" transaction. We agree that Proposed Rule 3522(a) adequately describes a class of transactions that carry an unacceptable risk of impairing an auditor's independence.

Retroactive Treatment. In discussing the Proposed Rule, the Release addresses the concept of the auditor being required to consider the potential impairment of independence for a transaction that at the time it was executed was not a "listed" (or substantially similar) transaction, but that subsequently becomes "listed." The Release also states, "[registered public accounting] firms should be cautious in participating in transactions that the firms believe could become listed." In our experience, neither an auditor nor its audit client can anticipate whether or not a transaction will become "listed" in the future. The Internal Revenue Service (IRS) does not provide advance notification of transactions that will or may become "listed." The Proposed Rule would place the audit committee and the auditor in the untenable position of having to predict the future actions of the IRS.

We believe if the conclusions on a transaction are reached in good faith and meet the criteria in Proposed Rule 3522(c) at the time the transaction is consummated, the transaction should not cause an independence impairment if it becomes "listed" at a later date. Rather, we suggest the change in status of a transaction to "listed" should be treated in a manner similar to the provision in the Release discussing Proposed Rule 3522(c), where the auditor's independence is not impaired as a result of a change in law after the service was provided or because the tax treatment simply turned out to be not allowed.



Office of the Secretary
Public Company Accounting Oversight Board
February 11, 2005
Page 5

Non-U.S. Issues. We are concerned that auditors outside the U.S. may not be sufficiently familiar with the term “listed” transactions (a U.S. tax term) and therefore will not understand the types of transactions “listed” by the IRS. As a result, we believe the Board should consider the impact of Proposed Rule 3522(a) on non-U.S. registrants and on U.S. registrants doing business in non-U.S. jurisdictions. It would be extremely difficult and complex for auditors outside of the U.S. to identify non-U.S. transactions that are substantially similar to “listed” transactions in the U.S. Furthermore, a transaction that is substantially similar to a U.S. “listed” transaction may be permissible in a non-U.S. jurisdiction. Given the Board’s statement in the Release that “Proposed Rule 3522(a) is narrowly tailored to describe a class of potentially abusive transactions...,” we propose that Proposed Rule 3522(a) should be limited in its application to the U.S. tax consequences of a transaction.

In the event that Proposed Rule 3522(a) is not limited in its application to the U.S. tax consequences of a transaction, we ask the Board to provide detailed guidance, sufficient to enable non-U.S. auditors to comply. For example, we believe guidance is necessary on how a “listed” transaction would be defined for transactions outside the U.S., and whether it would be necessary for non-U.S. auditors to understand each individual transaction “listed” by the IRS and to identify “substantially similar” transactions in the non-U.S. jurisdiction.

Confidential Transactions (Proposed Rule 3522(b))

Non-U.S. Issues. We are concerned that auditors outside the U.S. may not fully understand the meaning of “confidential” transactions. Like “listed” transactions, “confidential” transactions, as used in this context, is a U.S. tax term. Confidentiality requirements and practices vary throughout the world and application of the U.S. concept in non-U.S. jurisdictions could conflict with longstanding and legally recognized practices in other countries. For example, in some non-U.S. jurisdictions clients may be prohibited from sharing tax treatments with third parties. We suggest that the Board not require the application of Proposed Rule 3522(b) to non-U.S. auditors.

In the event that Proposed Rule 3522(b) is applied to non-U.S. auditors, we ask the Board to provide detailed guidance, sufficient to enable non-U.S. auditors to comply with both the Final Rule and potentially conflicting local laws and regulations.

Aggressive Tax Positions (Proposed Rule 3522(c))

Determining Third Party Involvement. The proposed requirement that an auditor would have an affirmative obligation to ascertain that a transaction was not initially recommended by another tax advisor is problematic if the auditor cannot rely on the audit client’s representation. Certainly, if the auditor has knowledge of the involvement of a third party tax advisor, the provisions of Proposed Rule 3522(c) should apply. However, we have not been able to identify any additional procedures the auditor could perform to reliably identify the participation of a third party tax advisor.



Office of the Secretary
Public Company Accounting Oversight Board
February 11, 2005
Page 6

Accordingly, if the auditor has no such knowledge and the client represents that the transaction was not initially recommended by a third party tax advisor, we believe Proposed Rule 3522(c) should not become operative.

If the Final Rule is not revised in this respect, we ask that the Board provide clear guidance on how an auditor can reach the level of reasonable, good faith diligence to reveal that another tax advisor initially recommended the transaction.

Advising Not "More Likely Than Not." It is common practice for an audit client to approach the auditor with a transaction the client is contemplating in order to obtain the auditor's thoughts and advice. If the transaction was initially recommended by a third party tax advisor, we believe the auditor's independence should not be impaired if the conclusion given by the auditor is that the transaction does not meet the "more likely than not" standard. Further, in cases where the auditor advises the client that the "more likely than not" standard is not met, we believe the auditor's independence should not be impaired if the client nevertheless decides to proceed with the transaction. We ask that the Board clarify that independence is not impaired in these circumstances.

Meaning of "Transaction." We suggest the Board provide clarification of the meaning of "transaction" as used in Proposed Rule 3522(c). For example, where an audit client is contemplating a business combination and the auditor provides tax services in relation to the proposed business combination, we suggest the Board clarify that the term "transaction" refers to tax advice provided in relation to the transaction and not to the business combination itself. We also suggest that Proposed Rule 3522(c) be clarified to permit an auditor to advise the audit client regarding alternatives available for tax return reporting of client initiated business transactions that are consummated before the auditor provides such advice.

Non-U.S. Issues. The concept "more likely than not" is a U.S. tax concept. In many cases, tax advisors in non-U.S. jurisdictions do not apply this terminology. Furthermore, footnote 70 in the Release only references a review by the IRS whereas non-U.S. transactions would be reviewed by a local taxing authority. The Board should clarify that "more likely than not" means that there is a greater than 50 percent chance that a tax position, if challenged by the relevant tax authority, would prevail.

Tax Services for Senior Officers of Audit Client (Proposed Rule 3523)

Financial Reporting Oversight Role. In order to provide a level of consistency with the SEC's independence rules, we believe the prohibition in Proposed Rule 3523 should include all employees in a financial reporting oversight role, whether or not they are officers of an issuer. We also believe the definition of employees to whom an auditor should not provide tax services should be expanded



Office of the Secretary
Public Company Accounting Oversight Board
February 11, 2005
Page 7

to include immediate family members of employees in financial reporting oversight roles of an issuer.

Non-Executive Directors. We agree that providing tax services to non-executive members of the board of directors should not impair or be perceived to impair an auditor's independence. Further, we believe a prohibition on such services may pose undue hardship for board members that participate on multiple boards served by different accounting firms, as such prohibition could significantly limit a director's options for obtaining quality tax services.

Newly Appointed Persons. Proposed Rule 3523 does not address situations in which a person is promoted during the year from a non-financial reporting oversight role into a financial reporting oversight role. In the interest of fairness to such employee, we suggest that an auditor be permitted to continue to provide tax services related to that particular tax year without impairing independence.

Audit Committee Pre-Approval of Certain Tax Services (Proposed Rule 3524)

Engagement Letters. In line with the SEC's Final Rules stating that effective oversight of the financial reporting process is fundamental to preserving the integrity of our markets, the critical role played by audit committees in the financial reporting process and the unique position of audit committees in assuring auditor independence is widely recognized. We believe audit committees have taken their obligations for pre-approving services, including tax services, seriously and have established robust policies, procedures, and processes for doing so. Consistent with an audit committee's pre-approval policies, procedures, and processes, some audit committees may insist on receiving all engagement letters while other audit committees may require other forms of documentation for their review. In larger companies, auditors often provide routine tax compliance services in many (sometimes hundreds) of jurisdictions. Often, particularly in non-U.S. jurisdictions, this work is covered by individual engagement letters. Requiring the audit committees to receive (and implicitly to review) hundreds of engagement letters covering routine tax services will not improve audit committee oversight and could be counter productive in that regard. Accordingly, we believe audit committees should continue to make their own informed judgments about the nature of documentation required for pre-approving tax services.

If the Board believes it must mandate that the auditor provide individual engagement letters to the audit committee, we suggest that the mandate be limited to engagement letters for tax services other than routine tax compliance services or those with fees that exceed a pre-determined threshold (we suggest 5% of total fees, consistent with the de minimis threshold for pre-approval in the SEC rules). Where the auditor is not required to provide particular engagement letters, the audit committee, nevertheless, would still have the authority to require the auditor to provide the letters.



Office of the Secretary
Public Company Accounting Oversight Board
February 11, 2005
Page 8

Information About Independence Issues. The Release also discusses that the auditor should convey information to the audit committee that is sufficient to distinguish between tax services that could have a detrimental effect on the auditor's independence and those that would not. The example given in the Release relates to tax compliance services being provided in the absence of a competent internal tax department. The Release implies a detrimental effect on the auditor's independence in that event. We believe that the Board should reconsider this particular example. Some readers may improperly infer from it that if there is not a formal internal tax function at an audit client the auditor automatically assumes a management function, thereby impairing independence. However, there may be individuals at the audit client that can make informed judgments and take responsibility for the auditor's work. This is particularly important for small and mid-size SEC registrants and SEC registrants that operate in multiple jurisdictions but that do not maintain in-house tax staffs for each jurisdiction.

Effective Date

Tax Engagements in Process. The Proposed Rules call for significant and complex changes to the current independence requirements for tax engagements. Further, many tax engagements that were previously pre-approved by the audit committee (or for services to officers that did not require pre-approval but were nonetheless permitted services) cannot be completed by October 20, 2005. The potential disruption that could be caused by abruptly terminating such engagements should be recognized and considered by the Board. We suggest a transition provision that is consistent with the transition provisions for engagements in process adopted by the SEC in implementing its 2003 independence rulemaking. We believe the Final Rules should apply to all tax engagements entered into after the effective date, and that tax engagements entered into pursuant to contracts in existence on the effective date should be completed no later than one year after the effective date.

Services Related to Past Tax Returns. We believe that employees in a financial reporting oversight role should be permitted to continue to utilize the auditor in connection with applicable past tax matters.

Non-U.S. Issues. The proposed effective date is based on tax return due dates under the U.S. tax system, however the Rules will affect jurisdictions outside the U.S. which have differing due dates. Therefore, in the event that the Board adopts its proposed effective date, we believe the Board should clarify that in non-U.S. jurisdictions, providing tax services applicable to the 2004 tax year to employees in a financial reporting oversight role will not impair independence.



Office of the Secretary
Public Company Accounting Oversight Board
February 11, 2005
Page 9

We would be pleased to clarify any comments or answer any questions about our comments. Please call or write either David Winetroub (212) 909-5552, dawinetroub@kpmg.com or Frank Lavadera (212) 909-5448, flavadera@kpmg.com.

Very truly yours,

KPMG LLP

cc:

William J. McDonough, Chairman, Public Company Accounting Oversight Board
Kayla J. Gillan, Member, Public Company Accounting Oversight Board
Daniel L. Goelzer, Member, Public Company Accounting Oversight Board
Willis D. Gradison, Jr., Member, Public Company Accounting Oversight Board
Charles D. Niemeier, Member, Public Company Accounting Oversight Board
Douglas R. Carmichael, Chief Auditor, Public Company Accounting Oversight Board
Donald T. Nicolaisen, Chief Accountant, Securities and Exchange Commission
Andrew D. Bailey, Jr., Deputy Chief Accountant, Securities and Exchange Commission

KPMG International is a Swiss cooperative that serves as a coordinating entity for a network of independent member firms. KPMG International provides no audit or other client services. Such services are provided solely by member firms in their respective geographic areas. KPMG International and its member firms are legally distinct and separate entities. They are not and nothing contained herein shall be construed to place these entities in the relationship of parents, subsidiaries, agents, partners, or joint venturers. No member firm has any authority (actual, apparent, implied or otherwise) to obligate or bind KPMG International or any member firm in any manner whatsoever, or vice versa.

Responsibility Not to Cause Violations (Proposed Rule 3502)

A. The Board Should Not Incorporate the Concept that an Individual Can Negligently Cause an Intentional Violation into its Final Rule.

As the Board recognized in its Release, although some of the underlying violations the Board is seeking to prevent are themselves defined as requiring “scienter,” a person might run afoul of Proposed Rule 3502 as currently worded if that person were to negligently “cause” a firm to take actions that would violate the Sarbanes-Oxley Act only if the primary actors had undertaken those actions knowingly or recklessly. But the idea that one individual could negligently “cause” others to commit an intentional violation makes little sense as a matter of logic. Failure to thwart an intentional illegal act might permit a violation to occur, but such a failure would not negligently or unintentionally “cause” (or even “contribute to”) an intentional violation; the intent of the primary parties would be an intervening cause of the illegal act.

The SEC, when invoking its “cease-and-desist” authority under Section 21C of the Securities Exchange Act, 15 U.S.C. 78u-3, has limited its assertion that “negligence is sufficient to establish ‘causing’ liability” to those situations in which “a person is alleged to ‘cause’ a primary violation that does not require scienter.” *See Howard v. SEC*, 376 F.3d 1136, 1141 (D.C. Cir. 2004) (quoting *In re KPMG Peat Marwick LLP*, Exchange Act, Release No. 43862, 2001 WL 47245, 19 (Jan. 19, 2001)). Where the primary violation requires scienter, the SEC instead requires a finding that the individual targeted by the cease-and-desist order had “aided and abetted” the firm’s primary violations of the securities laws. *See Id.* “Aiding and abetting” is a much higher standard than negligence, as the PCAOB legal staff noted in the Board’s meeting on December 14, 2004, see PCAOB Meeting Transcript, 12/14/2004, at 36, and can be proven only when the accused is shown to have had knowledge of the wrongdoing, or when his/her ignorance of the wrongdoing was the product of extreme recklessness. *See Howard*, 376 F.3d at 1143. Proving that a person “should have known” his acts would cause (let alone “contribute to”) an entity to commit a primary violation that itself can only occur when the primary parties have knowingly or recklessly violated the securities laws is not enough to hold that person liable for the violation, *see id.*, and the Board should amend Proposed Rule 3502 so that, like the SEC, it will not purport to hold a person liable for a violation requiring knowledge or intent when that person’s participation in the violation was, at worst negligent.

In sum, with respect to the issue raised at page 19 of the Release, we believe that, if the Board is to incorporate punishment for negligently causing primary violations into the Final Rule, it should limit such punishment to instances in which the primary violation does not require “scienter.”



B. If the Rule is to Punish Individuals for Negligence, It Should not Equate “Causation” with “Contribution”, Because Such an Equation Would Be Unduly Vague, Would Be Unduly Punitive for Disciplinary Proceedings, and Could Be Inconsistent with Provisions of the Act.

The current text of Proposed Rule 3502 states that persons “associated with a registered public accounting firm shall not cause that . . . firm to violate the Act, the Rules of the Board, [or other provisions of law], due to an act or omission the person knew or should have known would contribute to such violation.” We believe that the use of the word “contribute” is unduly vague, because it could arguably subject individuals to punishment for unforeseeable violations of which their own acts or omissions were not the proximate or legal cause whenever anyone can demonstrate that the violation might not have occurred “but for” the original acts or omissions.

The Release repeatedly states that the Proposed Rule aims to prevent individuals from “causing” violations by their firms, and claims that “[t]he phrase ‘knew or should have known would contribute to such violation’ . . . is intended to articulate a negligence standard.” This language equating “contribution” with “causation” is borrowed wholesale from Section 21C of the Securities Exchange Act, which gives the SEC authority to issue “cease-and-desist” orders, *see* PCAOB Meeting Transcript, 12/14/2004, at 37. The Release cites to *KPMG LLP v. SEC*, 289 F.3d 109 (D.C. Cir. 2002), in support of its assertion that this language from Section 21C properly articulates a negligence standard.

But this language from Section 21C does not support the use of the “contribution” language in Proposed Rule 3502, because the Proposed Rule will be disciplinary in nature, and the SEC uses the relevant language in Section 21C only when utilizing its “cease-and-desist” powers, and not when seeking to impose other disciplinary sanctions. As the D.C. Circuit pointed out in the *KPMG* case, “cease-and-desist” proceedings and disciplinary proceedings are different types of proceedings involving “fundamentally different remedies.” *See* 289 F.3d. at 119. As even the headings given the relevant sections of the Act indicate, the Board’s powers are entirely “disciplinary,” *see* Section 105, and the Board may seek to prevent violations solely through the deterrent power of “sanctions.” *See* Section 105(c)(4). The Board’s disciplinary power are retrospective in nature, and while the Proposed Rule contemplates punishment for individuals, it does not contemplate “cease-and-desist” remedies to secure prospective compliance by those individuals. Indeed, “cease-and-desist” orders are not included in the statutory list of “sanctions” that the PCAOB may impose under the Act, and they are different in kind from such sanctions.¹ Consequently, contrary to what the Release accompanying Proposed Rule 3502 implies, the D.C. Circuit has not approved Section 21C’s “contribution” language as an appropriate negligence standard for the imposition of disciplinary sanctions. Rather, that court held that negligence was a permissible standard for the very different authority – indeed, the very different type of proceeding – embodied in the SEC’s “cease-and-desist” power.

¹ The SEC itself was not granted the authority by Congress to issue cease-and-desist orders until 1990.



The use of a standard equating “contribution” with “causation” would be vague enough to risk conflict with the Act’s provisions governing sanctions for “failure to supervise.” Section 105(c)(6) of the Act states that supervisory personnel may be sanctioned for failing to supervise their subordinates, but also provides a safe harbor for supervisors if the firm has established a reasonable program to require compliance and detect violations of the Act or the rules of the Board, and where supervisors reasonably discharged their duties under that compliance program. While it is hard to imagine that supervisors who had followed such a program in such a case could be found to have actually caused their subordinates’ violations, it would be much easier to attack the safe harbor by suggesting that some tangential failure to rigorously discipline or terminate a subordinate somehow “contributed” to a future violation by that subordinate. In such an instance, Proposed Rule 3502’s “contribution” language might eviscerate the protection guaranteed by the Act and upset the balance struck by Congress, which has tried to balance its desire to minimize violations against its recognition that no compliance program can be absolutely foolproof.

In sum, we believe that, if the Board is to incorporate punishment for negligence into the Final Rule, it should avoid vagueness and unfair results by replacing the word “contribute” with the word “cause.”

C. We Respectfully Suggest that the Board Should Not Adopt “Negligence” as the Standard For Liability.

Although we recognize that the Release advocates the creation of a “negligence” standard that would support the imposition of certain penalties, we respectfully suggest that there are at least two sound legal and policy reasons to reconsider that position.

First, given the vast body of technical rules and guidance to be applied, along with the difficulties inherent in the application of those rules in real time and to complex fact patterns, penalizing negligent conduct would be oppressive and draconian.² There is no reason to believe that Congress feels that such penalties are necessary. Simple negligence as an articulated level of intent justifying PCAOB sanctions appears nowhere in Section 105(c) of the Act, the source of the Board’s authority to sanction persons who violate the Act, certain securities laws, or rules of the SEC or the Board. On the contrary, the only place where the Act discusses levels of intent as prerequisites for the imposition of sanctions is in Section 105(c)(5), where Congress expressly limits the imposition of

² A reading of Section 105(c) advanced in the Open Meeting, *see* Transcript at 37-38, that the sanctions not reserved exclusively for “intentional or other knowing conduct” are somehow “light” sanctions, is mistaken. Censure is without question a serious sanction, one which will be reported to state regulators and to the public at large, *see* Section 105(d), and which will therefore severely impact the sanctioned person’s career. Indeed, the analogous SEC sanction of censure under Rule 102(e) may only be imposed in cases of intentional wrongdoing. Similarly, a penalty of \$100,000 (for individuals) or \$2,000,000 (for firms) under Section 105(c)(4)(D)(i) is scarcely a light penalty. The catch-all provision in Section 105(c)(4)(G), moreover, arguably allows for the imposition of similarly weighty sanctions the Board might adopt. It is thus difficult to argue that Congress plainly intended that such severe sanctions – including sanctions defined solely by the Board and not by Congress – could be imposed for merely “negligent” conduct.



certain penalties to cases of intentional, knowing, or reckless conduct, or to repeated instances of negligent conduct. The signal from Congress is thus that the Board should be wary of imposing sanctions not grounded on intentional conduct.

Second, the practical implications of incorporating a negligence standard into the Final Rule would be sweeping and severe. Such a standard would expose hundreds of thousands of individuals in the accounting field to the risk of severe sanctions for actions that might in some remote way be tied to a violation of the Act or of the securities laws. Even a tightly-limited negligence standard (which we respectfully suggest the Proposed Rule as drafted is not) would inject a great deal of uncertainty into even the most mundane decisions that auditors make every day, and would place intolerable pressure on the difficult judgment calls that those who operate in this highly technical field must make on a regular basis. A “negligence” rule is particularly ill-suited for retrospective judgments about compliance with “professional standards,” and such a rule would operate as an invitation for after-the-fact attacks on conduct that was, at the time, objectively reasonable. Significantly, as discussed above, the SEC itself does not use a mere “negligence” standard to impose sanctions.

In sum, we believe that Proposed Rule 3502 will be more fair and effective if the Board eliminates the words “or should have known” from the last clause of the Proposed Rule.

Conclusion

Proposed Rule 3502 and the Release inadequately describe the basis and limits of the Board’s reasoning in seeking to adopt a “negligence” standard. Moreover, there are sound policy reasons, grounded in concerns about vagueness and fairness, why the Board should not try to assert such power. Accordingly, we recommend that the Board adopt a more limited standard in accordance with the Board’s authority and the sanction scheme established by Act. Specifically, the last clause of Rule 3502 should read “due to an act or omission the person knew would cause such violation.” This language properly respects the severity of the Board’s disciplinary powers under the Act, reflects the complexities inherent in the application of the relevant rules and professional standards, and allows persons associated with registered public accounting firms to better understand their obligations and any potential sanctions for their acts or omissions.