

May 12, 2003

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. 004
Statement Regarding the Establishment of Auditing and Other Professional Standards**

The American Institute of Certified Public Accountants (“AICPA”) respectfully submits the following written comments on the Public Company Accounting Oversight Board’s (“PCAOB” or the “Board”) proposed rules regarding the establishment of auditing and other professional standards for registered public accounting firms. The AICPA is the largest professional association of Certified Public Accountants in the United States, with more than 350,000 members in public practice, business, industry, government and education.

The AICPA recognizes the enormous effort put forth by the PCAOB members and staff to implement the provisions of the Sarbanes Oxley Act (“the Act”). Initially, a significant responsibility of PCAOB will be to help restore public confidence in audited financial statements of public companies (“issuers”), of which the establishment and maintenance of high quality auditing and other professional standards is critical to that goal. The AICPA is committed to working with the PCAOB to continue developing high quality standards for audits of issuers.

Based on our many years of experience in setting high quality auditing and other professional standards, we offer the following comments, which we believe will provide greater transparency to the PCAOB’s process for setting standards, and provide clarity and other improvements.

In general, the final PCAOB statement should:

- Provide significant transparency and public participation in the PCAOB’s standards-setting process, including a process that would:
 - require the Board to develop, debate and approve technical professional auditing and other standards in public meetings or in “the sunshine”
 - provide sufficient time for public comment on proposed standards

- address PCAOB process issues associated with cooperation and participation with international and other standard setters.
- Create a sufficient number of advisory groups having knowledge of the broad nature and applicability of standards, and clarify their role and operating procedures.
- Avoid confusion over the scope of applicable standards by clearly defining terms.
- Clarify applicability of standards to registered public accounting firms.

Provide significant transparency and public participation in the PCAOB's standards-setting process

Public Debate of the Standards

We recognize that the PCAOB is still in a start up mode and therefore the Board may not have had a great deal of time to recognize and consider all important issues that it will need to deal with in its standard setting process. Additionally, we recognize the Board's need to provide some degree of flexibility in the standard setting process. Nevertheless, we believe that the Board should commit to issue for comment, in the near future, more specific policies and procedures on how professional standards will be set.

Appendix 1 of the PCAOB proposal sets forth Proposed Rules 1001, 3100, and 3700 for which our specific comments relating to those sections are discussed below. It does not set forth any Proposed Rules governing the PCAOB's standard setting process, which is briefly described in the body of the release.

Page 2 of the release invites comment on the proposed rules (3100 and related definition in 1001, and 3700). Since section 3700 deals only with the formation, etc. of the advisory group(s), it isn't clear that comment on the PCAOB's general standard setting process is open for comment. However, Item F on page 15 "invites the views of interested persons with respect to the issues raised for comment in this release," which presumably also encompasses the description of the PCAOB's standard setting process generally. Accordingly, we submit for your consideration the following general comments concerning the PCAOB's standard setting process for auditors of issuers.

In the proposed rule –

- No mention is made about whether PCAOB meetings to deliberate new standards or amendments to existing standards will be open to the public or closed. We believe all Board meetings to deliberate or approve professional auditing and other standards or amendments should be open to the public.

Currently, all AICPA committee meetings at which standard-setting activities are conducted (e.g., Auditing Standards Board (“ASB”) and Professional Ethics Executive Committee (“PEEC”)) are open to the public. During these meetings, any individual is free to listen to the debates on the technical merits and nuances of each proposed new or amended standard. Additionally, it is customary for the chair of the committees to give the privilege of the floor to certain non-committee members to address the committee and to join in the debate and discussion of a proposed standard. This is particularly helpful when the committees are dealing with very complex or specialized areas or when dealing with a particular industry.

We believe that Board policy should be to review and debate each paragraph or section of a proposed standard in an open meeting. By debating each important technical nuance of a standard and then making the necessary and proper wording changes in a public forum provides transparency as to why certain positions are taken by the Board or its staff. This type of open and transparent process (which is the model commonly followed by other standard setters including FASB) allows observers the ability to understand the reasoning of the Board and most importantly allows observers the ability to understand the Board’s rationale. We have always felt and will continue to believe that an open and public debate of the standards by the members of the standard setting body is in the public’s best interest.

It is through this due process of open and public debate leading to an ultimate consensus by those most knowledgeable in the subject matter of the proposed standard that gives a standard “general acceptance.”

A decision of the Board not to debate each technical nuance of each standard will not permit public observers the ability to understand each Board member’s views and rationale on the merits of the standard. To develop a standard otherwise, without an open, robust debate of the standard by the Board and the profession, will result in a standard that is less likely to be viewed as “generally accepted.”

Additionally, we hope that the chair of the PCAOB will permit professional experts the privilege of the floor to engage in the debate as the Board discusses a proposed standard. We believe the Board will find this particularly helpful when dealing with a very complex or specialized area or one dealing with a particular industry. This allows the best and the brightest minds the opportunity to develop the best auditing and other standards in the public’s interest.

- No mention is made of the process the Board will follow at the end of a comment period before remitting the proposed standard to the Securities and Exchange Commission for approval. Will the Board make revisions based on comments received and submit the revised document to the Commission for its exposure process? And if so, will the Board make an analysis available to the public at an open meeting showing how each comment letter was disposed? Additionally, when the Commission receives comments, will the Commission deliberate the proposed

standard and comments in a public forum and revise the proposed standard, or turn the document and the comments back to the PCAOB for disposition?

- The PCAOB identifies three priority projects: a review of interim or transitional standards; implementation of provisions of the Act that require the Board to adopt standards in specific areas; and standards related to internal control reporting pursuant to section 404 of the Act.

Page 10 of the release states, “the schedule and procedure for the review of the interim standards will be the subject of a separate release. The Board invites public comment and suggestions concerning the appropriate priorities for the review of the Interim Professional Auditing Standards and concerning any changes to them that the Board should consider.” Because it isn’t clear whether that comment is being invited now or when the separate release comes out we believe that the PCAOB should separately seek the input of the public on its priorities.

For example, the ASB’s current proposed standards dealing with audit risk are not listed as a priority. We believe that the Board should undertake, as a priority, its consideration and review of these proposed standards and amendments because we believe that the requirements and guidance provided in the proposed standards, if adopted, would result in a substantial change in audit practice and in more effective audits. Additionally, because these proposed standards have been developed jointly between the ASB and the International Auditing and Assurance Standards Board (“IAASB”) failure to act timely on these proposals will create significant differences between PCAOB standards applicable to audits of issuers and international and other auditing standards.

- Pages 13-14 of the release state, “the Board intends to convene a roundtable meeting in the near future to explore whether a new standard with respect to internal control reporting is needed in light of Section 404(b). The details of the Roundtable meeting will be the subject of a separate release. If the Board determines that such a standard is needed, it will commence a rulemaking proceeding, in accordance with the general procedures outlined in this release, to determine the nature and content of that standard. Interested persons will also be afforded an appropriate opportunity to express their views to the Board in that proceeding.” It is not clear from the “general procedures outlined in this release” in what manner “interested persons will also be afforded an appropriate opportunity to express their views to the Board in that proceeding.” We believe that the Board should clarify this issue as soon as possible.

Provide Sufficient Time for Public Comment

- The 21-day comment period described on page 7 of the release is, in our view, insufficient to make public input meaningful. Related footnote 6 further states “there may be occasional exceptions to the public comment process, such as in emergencies or other unusual circumstances where further public comment does not

appear necessary.” We believe the PCAOB should never issue a new or amended standard without thorough due process, including an appropriate exposure period. We further believe that the Board should provide examples of what such an emergency might be and how that emergency could be so great as to override the public’s right to due process through a comment period.

While we agree that the period for exposure could be shortened in some instances from the 60 -90 days typically used by other standard setters, we believe that a comment period of only three weeks is an unreasonably short period of time for a commenter to carefully analyze a proposed (and generally complex) standard and to engage its top technical personnel in the drafting of a comment letter. Particularly for smaller issuers and smaller registered CPA firms where the task of commenting rests with a very small number of individuals (perhaps with only one person) who are not solely devoted to one function within their company or firm, the PCAOB is unfairly slanting the comments it will receive to larger organizations and larger registered CPA firms.

Process of Cooperation and Participation with International and Other Standard Setters

Because there are often differences in the needs of users of audited financial statements, and because the PCAOB’s authority deals with audits of issuers who access the U.S. capital markets, there is likely to develop from PCAOB auditing standards certain auditing requirements that are either not applicable or not appropriate for audits of non-issuers. Maintaining standard setting processes that work cooperatively with other standard setters has to be in the best interest of all possible users and will only serve to enhance the standard setting processes for the PCAOB and other standard setters.

The efficiency of the world’s capital markets depends in part on quality professional auditing and other standards being of the same high quality and being applied consistently around the world. We encourage the PCAOB to work cooperatively with the international standard setters and undertake a standard setting process that will harmonize PCAOB standards with international auditing and other standards with a view towards convergence by 2005. Only through strong international auditing and other standards will public investors be assured that high quality audits are conducted around the world.

Accordingly, the PCAOB’s final statement should address process issues relative to working with other standard setters. This should encompass such matters as dealing with agenda-setting, cooperative development of proposed standards, the role of advisory boards and the need for broader international communication and exposure of proposed standards.

Create a sufficient number of advisory groups having knowledge of the broad nature and applicability of standards, and clarify their role and operating procedures

The proposed rule governing advisory groups set forth in Appendix 1 broadly outlines their formation (“the Board will convene one or more advisory groups”); composition (accounting, auditing, finance, governance, investing, and other); selection of members (by the Board, based upon recommendations by anyone); personal membership (member’s functions and responsibilities, including attendance at meetings, may not be delegated to others); ethical duties (compliance with EC 3, EC 8(a), and EC 9 of the PCAOB’s proposed Ethics Code); and ad hoc task forces (at the Board’s discretion; membership may include but is not limited to advisory group members).

Certain language in the release accompanying the Proposed Rules could be read to infer the PCAOB is considering only one advisory board, while other sections suggest the Board is open to the idea of multiple advisory boards.

Item B. on pages 5-7 suggest that the nature of the “assistance” to be provided by the advisory group (or groups) primarily will be as a source of ideas and comments on guidance drafted by staff or, in some cases, staff and ad hoc task forces, rather than a participant in the drafting of standards (or a “wordsmithing” type of reviewer). For example page 6 of the release states that the advisory group (among others) “may recommend to the Board that it propose a new standard or a change to an existing standard.” Page 6-7 of the release states that “with Board approval, the analysis and evaluation [of a recommended standard] by the Board’s staff (or task force) may be submitted to the advisory group (or, if established, a recognized sub-group of an advisory group) for consideration. Recommendations or comments from an advisory group...would then be submitted to the Board, or staff of the Board designated by the Board to receive such recommendations.” Page 7 further states that “the Board may also ask the advisory group or a task force to advise it concerning the proposal [a proposed rule], and the advisory group or task forces may, in some cases, hold hearings, convene roundtables, or commission research.”

Based on our understanding of how the Board intends to use an advisory group and given that the technical skills and competencies for the different areas of professional standards are not the same, (for example, someone specializing or knowledgeable in auditing standards would not necessarily have knowledge or the skills to deal with independence or quality control standards), we propose that there should be three (*at a minimum two*) advisory groups, one that focuses on auditing and attestation standards, one that focuses on quality control standards and one that focuses on ethics (including independence) standards. Members for each group should be selected on the basis of their expertise in those specific areas.

Additionally, no mention is made in the Proposed Rule or in the release of the following
—

- Whether advisory group meetings will be open to the public or closed. Additionally, there is no mention about how the advice rendered by the advisory group will be incorporated into the work of the Board and its staff. In order for the public to have

the confidence that the Board is responsive to the advice of any advisory group, we believe that these meetings should be open to the public.

- The number of members on the “one or more advisory groups.” (The release on page 8, however, states that “the Board contemplates that the advisory group will have somewhere between 15 and 30 members.”) The number of members on the advisory group (or groups) is a factor in determining how the advisory group will function and should be specified in the final rule.
- The term of service on an advisory group (or groups) nor who will chair such an advisory group and how that chair will be selected.
- The approximate number of advisory group meetings that will be held annually, or how far in advance the meeting dates will be established (which might help advisory group members in fulfilling their responsibility not to delegate attendance at meetings to others).
- How potential advisory group members will demonstrate their qualifications or their expertise in accounting, auditing, finance, governance, investing, or other disciplines.
- Any limits on the number of advisory members that could be associated with one firm, company or association. To select multiple members from the same firm, company or association will likely have the effect of limiting the views of the advisory group.
- Indications that public companies, firms or associations of different sizes would be represented. There are vast differences in the size and needs of issuers as well as vast differences in the size and needs of firms that audit issuers. Unless the views of these different sizes are represented, the staff and Board will not have the benefit of understanding the needs of these different constituents.

Avoid confusion over scope of applicable standards by clearly defining terms

1001. Definitions of Terms Employed in Rules

The Board uses the term professional auditing standards to mean “any auditing standard, standard for attestation engagements, quality control policy or procedure, ethical or competency standard, and independence standard (including any rule implementing title II of the Act) that is established or adopted by the Board under Section 103 of the Act.”

The PCAOB uses the term professional auditing standard rather than professional standards because the term professional standards is defined otherwise in Section 2(a)(10) of the Act, that is, the definition also encompasses accounting standards. The

term professional auditing standards is similar to that portion of the definition of the term professional standards that appears in Section 2(a)(10)(B) of the Act.

The characterization of attestation, quality control, ethical, and independence standards as professional auditing standards is not only imprecise but misleading. When the need arises to use a “generic” term, the PCAOB should consider using a term such as “professional standards other than accounting standards, including auditing standards, standards for attestation engagements, quality control policy or procedures, ethical or competency standards, and independence standards.” This would permit the PCAOB to remain consistent with the language in the Act without inappropriately misidentifying various types of professional standards.

The reason why it is inappropriate to use the term professional auditing standards to include other types of standards is because these other standards do not relate to the performance and reporting of an audit engagement. While we agree that these other standards are of utmost importance in creating a foundation for the auditing standards, they really are different in their applicability. For instance, quality control standards are standards governing a firm’s system of quality control that encompasses how an auditor performs an audit engagement. They also include guidance in other areas, for example, on how a firm monitors and inspects its quality control system that is not directly related to how an auditor carries out his or her audit responsibilities. Similarly, ethical and independence standards are applicable to all professional personnel (audit and non-audit) in the firm whereas auditing standards are applicable to an auditor in carrying out his or her audit responsibilities.

Under the transitional standards, an engagement partner will issue an audit report signed by his or her firm stating that the audit was conducted in accordance with “auditing standards generally accepted in the United States of America.” By encompassing all of these other non-audit standards within the definition of professional auditing standards, you are requiring an engagement partner to certify that all quality control, independence standards and attestation standards are also being followed throughout the firm for engagements and personnel who are unrelated to that specific audit engagement.

Presented a different way, if it was determined that a firm did not follow a specific quality control or independence standard applicable firm wide, the literal reading of the definition could lead someone to believe that every audit was deficient or substandard because professional auditing standards were not followed? We hope that was not the intent of the Board and therefore we believe that the definition of professional auditing standards should be modified to include only auditing standards.

The clarification of this issue is particularly important in light of Section 105 of the Act.

Additionally the Proposed Rules throughout discuss independence standards separately from ethical standards. Are independence standards deemed by the PCAOB (or by the Act) to stand apart from rather than be a subset of ethical standards? If so, we believe

that the PCAOB rules should describe the difference between the two and how they will be applied and enforced.

Clarify applicability of standards to registered public accounting firms

3100. Professional Auditing Standards Applicable to Registered Public Accounting Firms

The Proposed Rule states that “A registered public accounting firm and its associated persons shall comply with all applicable professional auditing standards.”

Read literally, this rule could be interpreted to mean that the firm and its personnel need to comply with PCAOB rules even for audits and other types of engagements performed for non-issuers. Therefore, we believe the final rule should clearly indicate that the PCAOB’s professional auditing and other standards apply only to a registered public accounting firm and its associated persons and only in their conduct of auditing issuers.

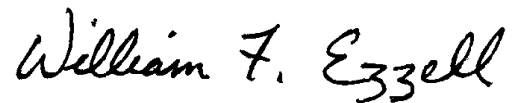
Additionally, the note underneath the rule states in part that “the Board intends that, during the period preceding the mandatory registration date, this rule would apply to public accounting firms that would be required to be registered *after* the mandatory registration date and to associated persons of those firms, as if those firms were registered public accounting firms” (italics added). As described in Appendix 2, this Proposed Rule is intended to be applicable to public accounting firms that will be required to register with the PCAOB in order to continue to participate in the audits of issuers after the mandatory registration date.

While we understand that the reason for this provision is to prevent firms that intend on registering from avoiding compliance with the rules prior to registration, the way the rule is written suggests that any public accounting firm that decides, at some future date (for example 10 years from now), to perform audits of issuers would have to follow the PCAOB’s professional auditing standards from the date that the Board adopts this rule. CPA firms who do not audit issuers today have no idea as to whether they will or will not audit an issuer in the future. Therefore, we recommend that the rule be rewritten to state, “this rule would apply to public accounting firms that would be required to be registered **on** the mandatory registration date.”

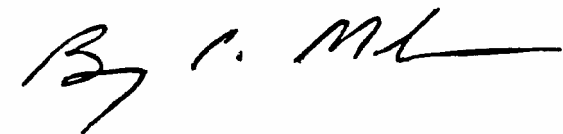
This identical wording also appears throughout the PCAOB's release on interim standards. Therefore, we believe such wording should be changed and conformed to the wording adopted for the final rule.

We appreciate the opportunity to comment on the proposed statement, and would be pleased to meet with Board members and staff to discuss our comments.

Sincerely,

Handwritten signature of William F. Ezzell in black ink.

William F. Ezzell, CPA
Chairman of the Board

Handwritten signature of Barry C. Melancon in black ink.

Barry C. Melancon, CPA
President and CEO