

May 12, 2003

Public Company Accounting Oversight Board
Attention: Office of the Secretary
1666 K Street, NW
Washington, DC 20006-2803

Re: PCAOB Rulemaking Docket Matter No. 004, Proposed Rules Relating to Professional Auditing Standards and Advisory Groups

PricewaterhouseCoopers LLP appreciates the opportunity to respond to the proposed rulemaking regarding the establishment of professional standards. We fully recognize and appreciate the authority of the Public Company Accounting Oversight Board (Board or PCAOB) to set such standards, a challenging task. In that connection, we agree with the basic proposal to involve others with an interest and expertise in such standards in the standards-setting process in an advisory capacity.

Within the context of that basic support, we have some recommendations for making the standards-setting process optimally effective. We also have identified a number of issues that the proposal does not address, but that are essential to be addressed in the interests of all who rely on the work of the auditing profession for the added credibility that auditors' reports bring to the financial marketplace.

Definition and Applicability of Professional Auditing Standards

Scope of Standards

Proposed Rule 1001(p)(iv) defines "Professional Auditing Standard." The delineation of areas in which standards are to be included within this definition appears to be appropriate. The Board specifically requested comment on whether there are other standards with which the Board should require registered firms to comply. We are not aware of any such standards.

Proposed Rule 3100 states that a registered public accounting firm and its associated persons must comply with "all applicable professional auditing standards." It is not clear what establishes the "applicability" of a professional auditing standard. In particular, the applicability of such standards could be to all professional engagements for which the Board

has issued standards performed by a registered public accounting firm and its associated persons, without regard to whether the client was an issuer or not.

We believe the Board should clarify what clients are covered. We believe that the intention of the Act was to provide oversight over the performance of public accounting firms with respect to issuers, and only that. We do not believe that an extension of the Board's authority to engagements for clients that are not issuers, even if performed by a registered public accounting firm, represents the intention of the Act.

Types of Standards to Be Established

Proposed Rule 1001(p)(iv) does not define what constitutes a "standard." The Interim Professional Auditing Standards adopted give an indication of what the Board intends to include within the concept of standards, but they also raise certain issues.

Specifically, Rule 3200T includes within auditing standards the entirety of generally accepted auditing standards, as described by Statement on Auditing Standard (SAS) No. 95, as amended. This is an appropriate construction for standards to be followed by registered public accounting firms and associated persons, but does not lead to clarity about which standards the Board intends to establish through its standards-setting process. Certainly, we expect that the Board would establish standards equivalent to the category of Auditing Standards in SAS No. 95. The use of the term "standards" in proposed Rule 1001(p)(iv) does not clarify the Board's role in establishing Interpretative Publications. While it may be expected that the Board will issue Auditing Interpretations, it is not as clear whether the Board will issue Guides and Statements of Position, many of which are industry-specific applications of Auditing Standards. (This discussion assumes that the Board will retain the basic structure of the documents contemplated by SAS No. 95.)

We believe that all related authoritative professional literature applicable to covered engagements performed by registered public accounting firms should be created by or under the direction of the same group, to reduce the likelihood that varying interpretations of the intended results will arise. Therefore, we believe the Board should retain authority for all Auditing Standards and Interpretative Publications that relate to the basic standards. However, we are concerned that the Board may not have the resources to issue guidance on applying this material to individual industries. Therefore, since such guidance is very important to effective implementation of the standards, we suggest that the Board consider the alternative of utilizing, under its direct supervision, the existing processes within the American Institute of Certified Public Accountants (AICPA), or appoint its own set of industry-oriented advisory groups, to ensure the continued availability of such industry-specific interpretative guidance.

The last category addressed by SAS No. 95, Other Auditing Publications, are by definition issued by a large number of parties. The Board may well choose to issue some materials that

would fall within this category. However, it is not practical for the Board to assume responsibility for all publications included in this category. This should be clarified in the final version of Rule 3200.

No Implied Private Right of Action

Though Congress did not explicitly create a private right of action for a violation of the Act's provisions, and we do not believe that such a right exists, we recommend that the Board expressly disclaim the Board's intent to create a private right of action, similar to that contained in the recent Final Rule of the Securities and Exchange Commission (Commission) regarding the "Implementation of Standards of Professional Conduct for Attorneys." To avoid any potential confusion, we recommend that the Board state as follows:

- The rules promulgated by the Board and the standards adopted by the Board pursuant to Section 103 of the Act are not intended to, and do not, create a private right of action against any registered public accounting firm or its associated persons based upon compliance or noncompliance with those rules.
- The rules promulgated by the Board and the standards adopted by the Board pursuant to Section 103 of the Act are intended to be enforced only by the Board and by the Commission.
- The ethics standards promulgated by the Board and the ethics standards adopted by the Board pursuant to Section 103 of the Act do not establish a standard of care that is relevant to prove professional negligence.

Applicability to Foreign Registered Public Accounting Firms

Proposed Rule 3100, as written, applies to all registered public accounting firms. However, certain of the Interim Professional Auditing Standards approved by the Board introduce requirements that heretofore have not been applicable to foreign auditors. Specifically, they include the following standards that have only been applicable to members of the AICPA:

- Rule 3400T includes quality control standards based on the ASB's Statements on Quality Control Standards (QC sec. 20-40) and certain membership rules of the AICPA SEC Practice Section. (Some, but not all, of these rules, such as concurring review requirements, have been applicable to foreign auditors.)
- Rule 3500T includes ethics standards based on Rule 102, and interpretations and rulings thereunder, of the AICPA's Code of Professional Conduct.
- Rule 3600T includes independence standards based on Rule 101, and interpretations and rulings thereunder, of the AICPA's Code of Professional Conduct, to the extent that they are more restrictive than the rules of the Commission.

We believe that the Board should specify that these Interim Professional Auditing Standards are not applicable to registered public accounting firms and their associated persons, when the firm is domiciled outside the United States, pending a further study of their applicability.

In addition, we are aware of a special arrangement the Commission has with respect to Canadian auditors whereby auditing standards generally accepted in Canada are deemed acceptable to the Commission when the auditor's report is included in a form filed under the Multijurisdictional Disclosure System (MJDS). We believe that the Board should specifically incorporate this arrangement in its application of Rule 3100 to the auditing standards to be followed by such firms.

The Standards-Setting Process

The only specific rule relating to the establishment of professional standards included in the rulemaking is proposed Rule 3700, Advisory Groups. However, the Statement accompanying the proposed rules includes additional discussion on the process that the Board intends to follow in its standards-setting. Therefore, we have not limited our comments to just proposed Rule 3700.

Composition of Advisory Groups

Proposed Rule 3700 appropriately, and consistent with the Sarbanes-Oxley Act of 2002 (Act), allows for the appointment of **one or more** advisory groups. However, the accompanying Statement, in places, implies that the Board may only appoint one such advisory group. We strongly encourage the Board to have separate advisory groups for each of the various types of standards to be established, that is, (i) auditing and attestation standards, (ii) quality control standards, and (iii) ethics and independence standards. Experience has shown that those with expertise in auditing may not have a similar degree of expertise in ethics and independence, and so forth.

We also note the intention of the Board, as presented in the Statement, to have representative complements of individuals from various backgrounds, with the intention of relatively equal representation from the accounting/auditing, finance, and investment fields. We understand the desire to have broad involvement of various groups in these endeavors. However, we believe that it is essential to involve, in a significant way, people with a deep understanding of how the standards are, or would be, implemented in practice, that is, auditors in public practice.

We also are aware of comments in various public forums to the effect that the time commitment expected of advisory group members, in at least some areas, will be significant. Given the nature of the subject matter to be addressed by these advisory groups, it may be difficult to attract sufficient candidates from the finance and investment fields to balance the number of accounting/auditing experts needed to effectively operate the advisory group. We encourage the Board to not set rigid requirements for proportional participation so that it not impede its ability to attract the necessary expertise and talent for its tasks.

Proposed Rule 3700 contains no indication of the length of service of advisory group members, or how the Chair of such groups would be selected. We recommend that the Chair of an advisory group be selected from among its volunteer members, and not be a Board staff person (or a Board member) to ensure that the advisory group is not encumbered in providing advice to the Board. Furthermore, we suggest that the members of an advisory group (as compared to an ad hoc task force) be appointed for a set term of, say, three years, and that the expirations of terms be staggered so that there is always a reasonable continuity of membership from year to year.

Ethics Obligations of Advisory Group Members

Proposed Rule 3700 appropriately requires that advisory group members participate on a personal basis, and that the members comply with certain specified ethical duties. However, we have the following observations and recommendations with respect to the provisions of the Board's Ethics Code cited in section (e) of the Rule, based on the proposed Ethics Code included in PCAOB Rulemaking Docket Matter No. 003:

- EC 8(a) required recusal in the event of “a financial interest or other similar relationship which might affect or reasonably create the appearance of affecting his or her independence or objectivity with respect to the Board’s function or activities.” However, it needs to be recognized that advisory group members all have other vocations, and they will need guidance on how this rule applies to their participation. They are not likely to be able to adhere to this rule in the same way that Board members and professional staff can.
- EC 9 limits the dissemination of information to which advisory group members may have access. However, we understand that advisory group members will be expected to use support personnel they have in their respective organizations to assist in the Board’s activities, a common occurrence by volunteers assisting professional organizations. If they are precluded from sharing agenda materials with these support personnel, their contribution may not be maximized. This should be clarified.
- We suggest that the Board consider including EC 10 (restrictions on speaking for the Board) and EC 14 (annual compliance certification) as applicable to advisory group members.

Other Standards-Setting Processes

The Statement accompanying the proposed rules refers to the following aspects of the standards-setting process:

- The Board will determine its own standards-setting priorities, and also will consider proposals submitted by others (and, in fact, encourages such submissions).
- The Board will utilize advisory groups, subgroups thereof, and/or ad hoc task forces to assist its staff in developing standards.
- The Board will solicit public comment on its proposals, and may convene hearings or roundtable meetings to obtain such input.

- Proposals for new standards will be published for comment, for a period of no less than 21 calendar days, unless the Board determines that a shorter period is necessary or appropriate under the circumstances or unless the Board determines that an emergency exists that would preclude a public comment period.
- After considering such input, the Board will consider the proposal and, by majority vote, determine whether to approve the standard.
- Any standard so approved requires approval by the Commission, which is also required to publish the Standard for comment. (We understand that the Commission normally permits a comment period of at least 30 days.)

We recognize that the Board needs some flexibility in the process used to develop proposals for standards. However, we believe that such activities need to be conducted within the broad principles of “sunshine” and due process. Therefore, we urge the Board to ensure that such activities take place with these principles in mind.

With that in mind, we have some recommendations about the processes set forth above:

- It is not clear whether the Board intends for its standards-setting meetings, including meetings of advisory groups, to be open to the public. Consistent with its present conduct of its affairs, we believe the Board should make it clear that all meetings at which proposed standards are discussed should be open to the public.
- We observe that a majority vote is anticipated for approval of a standard. We believe that a similar vote should be required for approval of a proposal released for public comment.
- Experience has shown that a comment period of 21 days is too short. We encourage the Board to allow a minimum of 30 days for proper consideration by commenters and, for more complicated proposals, to allow an exposure period of at least 60 days.

Review of Interim Professional Auditing Standards

The Statement accompanying the proposed Rules invites suggestions concerning priorities for the Board’s review of the Interim Professional Auditing Standards and any changes to them that the Board should consider. Based on our understanding of the content of the Interim Professional Auditing Standards, as discussed above, we have the following suggestions:

- Auditing standards
 - The Auditing Standards Board (ASB) proposed, last October, a significant series of revisions to current auditing standards around the subject of risk assessment. These revisions were developed jointly with the International Auditing and Assurance Standards Board (IAASB), and are a key element in the longer-term initiative to achieve greater convergence of U.S. and international auditing standards, within the overall goal of one set of global auditing standards. (We understand the ASB intends to submit to the Board a modified version of this proposal, to reflect comments received on its proposal. Comments were due to the ASB by April 30, 2003.) We

understand the IAASB may approve the final revisions to international standards on auditing as early as September 2003. We urge the Board to take expeditious action to integrate these revisions into auditing standards to be used in the U.S.

- A companion proposal to the proposed revision to AT 501 (discussed below) would establish an auditing standard requiring that an audit of internal control over financial reporting be performed in conjunction with an audit of financial statements for a public company, to effect the requirement of Section 103(a)(2)(A)(iii) of the Act. We encourage the Board to utilize this material in developing their response to this Section of the Act. (We understand the ASB intends to submit to the Board a modified version of this proposal, to reflect comments received on its proposal. Comments are due to the ASB by May 15, 2003.)
- The ASB proposed, earlier this year, a new standard relating to requirements for a reviewing partner and a series of amendments to existing standards (including a requirement for retention of audit documentation) responsive to various provisions of the Act. Among other things, these revisions would effect the requirements of Sections 103(a)(2)(A)(i) and (ii) of the Act. We encourage the Board to utilize this material in developing their response to these Sections of the Act, as well as to enhance the auditing standards for the other items contained therein. (We understand the ASB intends to submit to the Board a modified version of this proposal, to reflect comments received on its proposal. Comments are due to the ASB by May 15, 2003.)
- We are aware that the ASB has identified a number of other areas where existing auditing standards might be enhanced or improved, and that the ASB will be submitting recommendations to the Board in these areas. We encourage the Board to consider these recommendations. We believe that all of these matters relate to audits of issuers (as well as other entities), and therefore should be considered by the Board.
- Attestation standards
 - The ASB proposed, earlier this year, a revision of AT 501, *Reporting on an Entity's Internal Control over Financial Reporting*. These revisions were intended to clarify and expand the existing guidance to strengthen performance requirements for, in particular, the attestation required pursuant to Section 404 of the Act. While the Board has indicated its plan for addressing this area of standards, we believe this needs to be among the highest priorities of the Board in the near term. We are supportive of the ASB's proposal. (We understand the ASB intends to submit to the Board a modified version of this proposal, to reflect comments received on its proposal. Comments are due to the ASB by May 15, 2003.)
 - We do not believe there are any other aspects of the attestation standards that require immediate attention.
- Quality control standards
 - The AICPA is close to finishing a revision to its *Guide for Establishing and Maintaining a System of Quality Control for a CPA Firm's Accounting and Auditing*

Practice. This Guide is applicable to auditors of both public and nonpublic entities, and is not an authoritative portion of the quality control standards adopted by the Board as part of Rule 3400T. Still, we encourage the Board to endorse this Guide.

- Ethics and independence standards
 - The AICPA’s Professional Ethics Executive Committee (PEEC) has outstanding an exposure draft of proposed revisions to various aspects of the AICPA’s independence rules that would amend three interpretations to Rule 101 of the AICPA’s Code of Professional Conduct. The interpretations are Interpretation 101-3, *Performance of non-attest services*, 101-5, *Loans from financial institution clients*, and 101-13, *Extended audit services*. The proposed revisions of Interpretations 101-3 and 101-13, in particular, would tighten the current restrictions applicable to the provision of certain non-audit services. In addition, the PEEC is in the process of amending ethics ruling no. 91, *Member leasing property to or from a client*. We encourage the Board to include in its professional auditing standards any final revisions to the existing AICPA independence rules that it previously adopted on an interim basis. This is particularly important given that certain of the proposed amendments would institute requirements that are not presently contained in the independence rules of the Commission or the Independence Standards Board (ISB) and would tighten the current requirements of the existing AICPA rules.
 - During its existence, the ISB issued three independence standards and three independence interpretations. ISB Standard No. 2 was superseded by the Commission’s 2000 independence rule. However, that standard is still on the ISB’s website, although it contains a notation stating that it will never become effective because of comprehensive revisions made by the Commission to its rules on the same subject. We urge the Board to make clear that ISB Standard No. 2 is not among the Board’s Interim Professional Auditing Standards. In addition, certain aspects of ISB Standard No. 3 were effectively superseded by the Commission’s 2000 and 2003 independence rules. To avoid lending renewed authority to those aspects of ISB Standard No. 3, we recommend that the Board clarify that it is adopting on an interim basis only those aspects of ISB Standard No. 3 that were not effectively superseded by the Commission’s rulemaking.

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We appreciate the opportunity to express our views and would be pleased to discuss our comments or answer any questions that the staff may have. Please do not hesitate to contact Raymond J. Bromark (973-236-7781) or James S. Gerson (973-236-7247) regarding our submission.

Sincerely,

/s/ PricewaterhouseCoopers LLP