File No. PCAOB-2003-08
Consists of 237 Pages

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

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Form 19b-4

Proposed Rules

By

Public Company Accounting Oversight Board

In accordance with Rule 19b-4 under the
Securities Exchange Act of 1934

1. Text of the Proposed Rules

(a) Pursuant to the provisions of Section 107(b) of the Sarbanes-Oxley Act of 2002 (the "Act"), the Public Company Accounting Oversight Board (the "Board" or the "PCAOB") is filing with the Securities and Exchange Commission ("SEC" or "Commission") proposed rules consisting of ten Rules on Inspections and two related definitions. The proposed rules and definitions are attached as Exhibit A.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Board

(a) The Board approved the proposed rules, and authorized them for filing with the SEC, at its Open Meeting on October 7, 2003. No other action by the Board is necessary for the filing of these proposed rules.

(b) Questions regarding this rule filing may be directed to Gordon Seymour, Acting General Counsel (202-207-9034; seymourg@pcaobus.org); or Michael Stevenson, Associate General Counsel (202-207-9054; stevensonm@pcaobus.org).

3. Board's Statement of the Purpose of, and the Statutory Basis for, the Proposed Rules

(a) Purpose

Section 104 of the Act requires the Board to conduct a continuing program of inspections to assess the degree of compliance of each registered public accounting firm and associated persons of that firm with the Act, the rules of the Board, the rules of the Commission, or professional standards, in connection with its performance of audits, issuance of audit reports, and related matters involving issuers. The Board has adopted

Rules 4000 through 4010, and related definitions, to provide a procedural framework for the Board's inspection program.

(b) Statutory Basis

The statutory basis for the proposed rules is Title I of the Act.

4. Board's Statement on Burden on Competition

The Board does not believe that the proposed rules will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The proposed rules provide a procedural framework for the program of continuing inspections that the Act requires the Board to conduct. With respect to the firms to be inspected, the proposed rules impose no burden beyond the burdens clearly imposed and contemplated by the Act.

5. Board's Statement on Comments on the Proposed Rules Received from Members, Participants or Others

The Board released the proposed rules for public comment on July 28, 2003. See Exhibit 2(a)(1). The Board received 16 written comment letters relating to its proposal. See Exhibits 2(a)(2) and 2(a)(3).

The Board has carefully considered all comments it has received. In response to the written comments received, the Board has clarified and modified certain aspects of the proposed rules. The Board's response to the comments it received and the changes made to the rules in response to these comments are summarized in Exhibit 3 to this filing.

6. Extension of Time Period for Commission Action

The Board does not consent to an extension of the time period specified in Section 19(b)(2) of the Securities Exchange Act of 1934.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

8. Proposed Rules Based on Rules of Another Board or of the Commission

The proposed rules are not based on the rules of another board or of the Commission.

9. Exhibits

Exhibit A –	Text of Proposed Rules
Exhibit 1 –	Form of Notice of Proposed Rules for Publication in the Federal Register
Exhibit 2(a)(1) –	PCAOB Release No. 2003-013 (July 28, 2003)
Exhibit 2(a)(2) –	Alphabetical List of Comments
Exhibit 2(a)(3) –	Written comments on the rules proposed in PCAOB Release No. 2003-013
Exhibit 3 –	PCAOB Release No. 2003-019 (October 7, 2003)

10. Signatures

Pursuant to the requirements of the Act and the Securities Exchange Act of 1934, as amended, the Board has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

Public Company Accounting Oversight Board

By: _____
William J. McDonough
Chairman

Exhibit A – Text of Proposed Rules

SECTION 1. GENERAL PROVISIONS

Rule 1001. Definitions of Terms Employed in Rules.

When used in Rules, unless the context otherwise requires:

(a)(xi) Appropriate State Regulatory Authority

The term "appropriate state regulatory authority" means the State agency or other authority responsible for the licensure or other regulation of the practice of accounting in the State or States having jurisdiction over a registered public accounting firm or associated person thereof, with respect to the matter in question.

(p)(vi) Professional Standards

The term "professional standards" means –

(A) accounting principles that are –

(i) established by the standard setting body described in section 19(b) of the Securities Act of 1933, as amended by the Act, or prescribed by the Commission under section 19(a) of the Securities Act of 1933 or section 13(b) of the Securities Exchange Act of 1934; and

(ii) relevant to audit reports for particular issuers, or dealt with in the quality control system of a particular registered public accounting firm; and

(B) auditing standards, standards for attestation engagements, quality control policies and procedures, ethical and competency standards, and independence standards (including rules implementing Title II of the Act) that the Board or the Commission determines –

(i) relate to the preparation or issuance of audit reports for issuers; and

(ii) are established or adopted by the Board under section 103(a) of the Act, or are promulgated as rules of the Commission.

SECTION 4. INSPECTIONS

Rule 4000. General

Every registered public accounting firm shall be subject to all such regular and special inspections as the Board may from time-to-time conduct in order to assess the degree of compliance of each registered public accounting firm and associated persons of that firm with the Act, the Board's rules, the rules of the Commission, and professional standards, in connection with its performance of audits, issuance of audit reports, and related matters involving issuers. Inspection steps and procedures shall be performed by the staff of the Division of Registration and Inspections, and by such other persons as the Board may authorize to participate in particular inspections or categories of inspections.

Rule 4001. Regular Inspections

In performing a regular inspection, the staff of the Division of Registration and Inspections and any other person authorized by the Board to participate in the inspection shall take such steps, and perform such procedures, as the Board determines are necessary or appropriate**.** Such steps and procedures must include, but need not be limited to, those set forth in Section 104(d)(1) and (2) of the Act and such other tests of the audit, supervisory, and quality control procedures of the firm as the Director of the Division of Registration and Inspections or the Board determines.

Rule 4002. Special Inspections

In performing a special inspection, the staff of the Division of Registration and Inspections and any other person authorized by the Board to participate in the inspection shall take such steps, and perform such procedures, as are necessary or appropriate concerning the issue or issues specified by the Board in connection with its authorization of the special inspection.

Note: Under Section 104(b)(2) of the Act, the Board may authorize a special inspection on its own initiative or at the request of the Commission.

Rule 4003. Frequency of Inspections

(a) During each calendar year, beginning no later than the calendar year following the calendar year in which its application for registration with the Board is approved, a registered public accounting firm that, during the prior calendar year, issued audit reports with respect to more than 100 issuers shall be subject to a regular inspection.

(b) At least once in every three calendar years, beginning with the three-year period following the calendar year in which its application for registration with the Board is approved, a registered public accounting firm that, during any of the three prior calendar years, issued an audit report with respect to at least one, but no more than 100, issuers, or that played a substantial role in the preparation or furnishing of an audit report with respect to at least one issuer, shall be subject to a regular inspection.

(c) With respect to a registered public accounting firm that has filed a completed Form 1-WD under Rule 2107, the Board shall have the discretion to forego any regular inspection that would otherwise commence during the period beginning on the fifth day following the filing of the completed Form 1-WD and continuing until the firm's registration is deemed withdrawn or the firm withdraws the Form 1-WD.

Rule 4004. Procedure Regarding Possible Violations

If the Board determines that information obtained by the Board's staff during any inspection indicates that the registered public accounting firm subject to such inspection, any associated person thereof, or any other person, may have engaged, or may be engaged, in any act, practice, or omission to act that is or may be in violation of the Act, the rules of the Board, any statute or rule administered by the Commission, the firm's own quality control policies, or any professional standard, the Board shall, if it determines appropriate –

(a) report information concerning such act, practice, or omission to –

(1) the Commission; and

(2) each appropriate state regulatory authority; and

(b) commence an investigation of such act, practice, or omission in accordance with Section 105(b) of the Act and the Board's rules thereunder or a disciplinary proceeding in accordance with Section 105(c) of the Act and the Board's rules thereunder.

Note: The Board may, as appropriate, make referrals or report information to regulatory and law enforcement agencies other than those specifically described in Rule 4004.

Rule 4005. Record Retention and Availability

[Reserved]

Rule 4006. Duty to Cooperate With Inspectors

Every registered public accounting firm, and every associated person of a registered public accounting firm, shall cooperate with the Board in the performance of any Board inspection. Cooperation shall include, but is not limited to, cooperating and complying with any request, made in furtherance of the Board's authority and responsibilities under the Act, to –

(1) provide access to, and the ability to copy, any record in the possession, custody, or control of such firm or person, and

(2) provide information by oral interviews, written responses, or otherwise.

Rule 4007. Procedures Concerning Draft Inspection Reports

(a) The Director of the Division of Registration and Inspections shall make a draft inspection report available for review by the firm that is the subject of the report. The firm may, within the 30 days after the draft inspection report is first made available for the firm's review, or such longer period as the Board may order, submit to the Board a written response to the draft report.

(b) (1) In submitting a response pursuant to paragraph (a), the firm may indicate any portions of the response for which the firm requests confidential treatment under Section 104(f) of the Act, and may supply any supporting authority or other justification for according confidential treatment to the information.

(2) The Board shall attach to, and make part of the inspection report, any response submitted pursuant to paragraph (a), but shall redact from the response attached to the inspection report any information for which the firm requested confidential treatment and which it is reasonable to characterize as confidential.

(c) After receiving and reviewing any response letter pursuant to paragraph (a) of this rule, the Board may take such action with respect to the draft inspection report as it considers appropriate, including adopting the draft report as the final report, revising the draft report, or continuing or supplementing the inspection before issuing a final report. In the event that, prior to issuing a final report, the Board directs the staff to continue or supplement the inspection or revise the draft report, the Board may, in its discretion, afford the firm the opportunity to review any revised draft inspection report.

Rule 4008. Procedures Concerning Final Inspection Reports

Promptly following the Board's issuance of a final inspection report, the Board shall –

(a) make the final report available for review by the firm that is the subject of the report;

(b) transmit to the Commission the final report, any additional letter or comments by the Board or the Board's inspectors that the Board deems appropriate, and any response submitted by the firm to a draft inspection report; and

(c) transmit to each appropriate state regulatory authority, in appropriate detail, the final report, any additional letter or comments by the Board or the Board's inspectors that the Board deems appropriate, and any response submitted by the firm to a draft inspection report.

Rule 4009. Firm Response to Quality Control Defects

(a) With respect to any final inspection report that contains criticisms of, or potential defects in, the quality control systems of the firm under inspection, the firm may submit evidence or otherwise demonstrate to the Director of the Division of Registration and Inspections that it has improved such systems, and remedied such defects no later than 12 months after the issuance of the Board's final inspection report. After reviewing such evidence, the Director shall advise the firm whether he or she will recommend to the Board that the Board determine that the firm has satisfactorily addressed the criticisms or defects in the quality control system of the firm identified in the final inspection report and, if not, why not.

(b) If the Board determines that the firm has satisfactorily addressed the criticisms or defects in the quality control system, the Board shall provide notice of that determination to the Commission and to any appropriate state regulatory authority to which the Board had supplied any portion of the final inspection report.

(c) The Board shall notify the firm of its final determination concerning whether the firm has addressed the criticisms or defects in the quality control system of the firm identified in the final inspection report to the satisfaction of the Board.

(d) The portions of the Board's inspection report that deal with criticisms of or potential defects in quality control systems that the firm has not addressed to the satisfaction of the Board shall be made public by the Board –

(1) upon the expiration of the 12-month period described in paragraph (a) of this rule if the firm fails to make any submission pursuant to paragraph (a); or

(2) upon the expiration of the period in which the firm may seek Commission review of any board determination made under paragraph (b) of this rule, if the firm does not seek Commission review of the Board determination; or

(3) unless otherwise directed by Commission order or rule, 30 days after the firm formally requests Commission review pursuant to Section 104(h)(1)(B) of the Act.

Rule 4010. Board Public Reports

Notwithstanding any provision of Rules 4007, 4008, and 4009, the Board may, at any time, publish such summaries, compilations, or other general reports concerning the procedures, findings, and results of its various inspections as the Board deems appropriate. Such reports may include discussion of criticisms of, or potential defects in, quality control systems of any firm or firms that were the subject of a Board inspection, provided that no such published report shall identify the firm or firms to which such criticisms relate, or at which such defects were found, unless that information has previously been made public in accordance with Rule 4009, by the firm or firms involved, or by other lawful means.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34- ; File No. PCAOB-2003-08)

[Date]

Public Company Accounting Oversight Board; Notice of Filing of Proposed Rules on Inspections

Pursuant to Section 107(b) of the Sarbanes-Oxley Act of 2002 (the "Act"), notice is hereby given that on October 14, 2003, the Public Company Accounting Oversight Board (the "Board" or the "PCAOB") filed with the Securities and Exchange Commission (the "Commission") the proposed rules described in Items I, II, and III below, which items have been prepared by the Board. The Commission is publishing this notice to solicit comments on the proposed rules from interested persons.

I. Board's Statement of the Terms of Substance of the Proposed Rules

On October 7, 2003, the Board adopted rules related to investigations and adjudications. The proposal includes ten Rules on Inspections (PCAOB Rules 4000 through 4010, reserving Rule 4005) and 2 definitions that would appear in PCAOB Rule 1001. The text of the proposed rules and definitions is as follows:

SECTION 1. GENERAL PROVISIONS

Rule 1001. Definitions of Terms Employed in Rules.

When used in Rules, unless the context otherwise requires:

(a)(xi) Appropriate State Regulatory Authority

The term "appropriate state regulatory authority" means the State agency or other authority responsible for the licensure or other regulation of the practice of accounting in the State or States having jurisdiction over a registered public accounting firm or associated person thereof, with respect to the matter in question.

(p)(vi) Professional Standards

The term "professional standards" means –

(A) accounting principles that are –

(i) established by the standard setting body described in section 19(b) of the Securities Act of 1933, as amended by the Act, or prescribed by the Commission under section 19(a) of the Securities Act of 1933 or section 13(b) of the Securities Exchange Act of 1934; and

(ii) relevant to audit reports for particular issuers, or dealt with in the quality control system of a particular registered public accounting firm; and

(B) auditing standards, standards for attestation engagements, quality control policies and procedures, ethical and competency standards, and independence standards (including rules implementing Title II of the Act) that the Board or the Commission determines –

(i) relate to the preparation or issuance of audit reports for issuers; and

(ii) are established or adopted by the Board under section 103(a) of the Act, or are promulgated as rules of the Commission.

SECTION 4. INSPECTIONS

Rule 4000. General

Every registered public accounting firm shall be subject to all such regular and special inspections as the Board may from time-to-time conduct in order to assess the degree of compliance of each registered public accounting firm and associated persons of that firm with the Act, the Board's rules, the rules of the Commission, and professional standards, in connection with its performance of audits, issuance of audit reports, and related matters involving issuers. Inspection steps and procedures shall be performed by the staff of the Division of Registration and Inspections, and by such other persons as the Board may authorize to participate in particular inspections or categories of inspections.

Rule 4001. Regular Inspections

In performing a regular inspection, the staff of the Division of Registration and Inspections and any other person authorized by the Board to participate in the inspection shall take such steps, and perform such procedures, as the Board determines are necessary or appropriate**.** Such steps and procedures must include, but need not be limited to, those set forth in Section 104(d)(1) and (2) of the Act and such other tests of the audit, supervisory, and quality control procedures of the firm as the Director of the Division of Registration and Inspections or the Board determines.

Rule 4002. Special Inspections

In performing a special inspection, the staff of the Division of Registration and Inspections and any other person authorized by the Board to participate in the inspection shall take such steps, and perform such procedures, as are necessary or appropriate concerning the issue or issues specified by the Board in connection with its authorization of the special inspection.

Note: Under Section 104(b)(2) of the Act, the Board may authorize a special inspection on its own initiative or at the request of the Commission.

Rule 4003. Frequency of Inspections

(a) During each calendar year, beginning no later than the calendar year following the calendar year in which its application for registration with the Board is approved, a registered public accounting firm that, during the prior calendar year, issued audit reports with respect to more than 100 issuers shall be subject to a regular inspection.

(b) At least once in every three calendar years, beginning with the three-year period following the calendar year in which its application for registration with the Board is approved, a registered public accounting firm that, during any of the three prior calendar years, issued an audit report with respect to at least one, but no more than 100, issuers, or that played a substantial role in the preparation or furnishing of an audit report with respect to at least one issuer, shall be subject to a regular inspection.

(c) With respect to a registered public accounting firm that has filed a completed Form 1-WD under Rule 2107, the Board shall have the discretion to forego any regular inspection that would otherwise commence during the period beginning on the fifth day following the filing of the completed Form 1-WD and continuing until the firm's registration is deemed withdrawn or the firm withdraws the Form 1-WD.

Rule 4004. Procedure Regarding Possible Violations

If the Board determines that information obtained by the Board's staff during any inspection indicates that the registered public accounting firm subject to such inspection, any associated person thereof, or any other person, may have engaged, or may be engaged, in any act, practice, or omission to act that is or may be in violation of the Act, the rules of the Board, any statute or rule administered by the Commission, the firm's own quality control policies, or any professional standard, the Board shall, if it determines appropriate –

(a) report information concerning such act, practice, or omission to –

(1) the Commission; and

(2) each appropriate state regulatory authority; and

(b) commence an investigation of such act, practice, or omission in accordance with Section 105(b) of the Act and the Board's rules thereunder or a disciplinary proceeding in accordance with Section 105(c) of the Act and the Board's rules thereunder.

Note: The Board may, as appropriate, make referrals or report information to regulatory and law enforcement agencies other than those specifically described in Rule 4004.

Rule 4005. Record Retention and Availability

[Reserved]

Rule 4006. Duty to Cooperate With Inspectors

Every registered public accounting firm, and every associated person of a registered public accounting firm, shall cooperate with the Board in the performance of any Board inspection. Cooperation shall include, but is not limited to, cooperating and complying with any request, made in furtherance of the Board's authority and responsibilities under the Act, to –

(1) provide access to, and the ability to copy, any record in the possession, custody, or control of such firm or person, and

(2) provide information by oral interviews, written responses, or otherwise.

Rule 4007. Procedures Concerning Draft Inspection Reports

(a) The Director of the Division of Registration and Inspections shall make a draft inspection report available for review by the firm that is the subject of the report. The firm may, within the 30 days after the draft inspection report is first made available for the firm's review, or such longer period as the Board may order, submit to the Board a written response to the draft report.

(b) (1) In submitting a response pursuant to paragraph (a), the firm may indicate any portions of the response for which the firm requests confidential treatment under Section 104(f) of the Act, and may supply any supporting authority or other justification for according confidential treatment to the information.

(2) The Board shall attach to, and make part of the inspection report, any response submitted pursuant to paragraph (a), but shall redact from the response attached to the inspection report any information for which the firm requested confidential treatment and which it is reasonable to characterize as confidential.

(c) After receiving and reviewing any response letter pursuant to paragraph (a) of this rule, the Board may take such action with respect to the draft inspection report as it considers appropriate, including adopting the draft report as the final report, revising the draft report, or continuing or supplementing the inspection before issuing a final report. In the event that, prior to issuing a final report, the Board directs the staff to continue or supplement the inspection or revise the draft report, the Board may, in its discretion, afford the firm the opportunity to review any revised draft inspection report.

Rule 4008. Procedures Concerning Final Inspection Reports

Promptly following the Board's issuance of a final inspection report, the Board shall –

(a) make the final report available for review by the firm that is the subject of the report;

(b) transmit to the Commission the final report, any additional letter or comments by the Board or the Board's inspectors that the Board deems appropriate, and any response submitted by the firm to a draft inspection report; and

(c) transmit to each appropriate state regulatory authority, in appropriate detail, the final report, any additional letter or comments by the Board or the Board's inspectors that the Board deems appropriate, and any response submitted by the firm to a draft inspection report.

Rule 4009. Firm Response to Quality Control Defects

(a) With respect to any final inspection report that contains criticisms of, or potential defects in, the quality control systems of the firm under inspection, the firm may submit evidence or otherwise demonstrate to the Director of the Division of Registration and Inspections that it has improved such systems, and remedied such defects no later than 12 months after the issuance of the Board's final inspection report. After reviewing such evidence, the Director shall advise the firm whether he or she will recommend to the Board that the Board determine that the firm has satisfactorily addressed the criticisms or defects in the quality control system of the firm identified in the final inspection report and, if not, why not.

(b) If the Board determines that the firm has satisfactorily addressed the criticisms or defects in the quality control system, the Board shall provide notice of that determination to the Commission and to any appropriate state regulatory authority to which the Board had supplied any portion of the final inspection report.

(c) The Board shall notify the firm of its final determination concerning whether the firm has addressed the criticisms or defects in the quality control system of the firm identified in the final inspection report to the satisfaction of the Board.

(d) The portions of the Board's inspection report that deal with criticisms of or potential defects in quality control systems that the firm has not addressed to the satisfaction of the Board shall be made public by the Board –

(1) upon the expiration of the 12-month period described in paragraph (a) of this rule if the firm fails to make any submission pursuant to paragraph (a); or

(2) upon the expiration of the period in which the firm may seek Commission review of any board determination made under paragraph (b) of this rule, if the firm does not seek Commission review of the Board determination; or

(3) unless otherwise directed by Commission order or rule, 30 days after the firm formally requests Commission review pursuant to Section 104(h)(1)(B) of the Act.

Rule 4010. Board Public Reports

Notwithstanding any provision of Rules 4007, 4008, and 4009, the Board may, at any time, publish such summaries, compilations, or other general reports concerning the procedures, findings, and results of its various inspections as the Board deems appropriate. Such reports may include discussion of criticisms of, or potential defects in, quality control systems of any firm or firms that were the subject of a Board inspection, provided that no such published report shall identify the firm or firms to which such criticisms relate, or at which such defects were found, unless that information has previously been made public in accordance with Rule 4009, by the firm or firms involved, or by other lawful means.

II. Board's Statement of the Purpose of, and Statutory Basis for, the Proposed Rules

In its filing with the Commission, the Board included statements concerning the purpose of, and basis for, the proposed rules and discussed any comments it received on the proposed rules. The text of these statements may be examined at the places specified in Item IV below. The Board has prepared summaries, set forth in sections A, B and C below, of the most significant aspects of such statements.

A. Board's Statement of the Purpose Of, and Statutory Basis for, the Proposed Rules

(a) Purpose

Section 104 of the Act requires the Board to conduct a continuing program of inspections to assess the degree of compliance of each registered public accounting firm and associated persons of that firm with the Act, the rules of the Board, the rules of the Commission, or professional standards, in connection with its performance of audits, issuance of audit reports, and related matters involving issuers. The Board has adopted Rules 4000 through 4010, and related definitions, to provide a procedural framework for the Board's inspection program. Each of the rules and definitions is discussed below.

Rule 1001 – Definitions of Terms Employed in Rules

Appropriate State Regulatory Authority

As discussed in more detail below, the Board has decided to add a definition of the term "appropriate state regulatory authority." The definition of that term in Rule 1001(a)(xi) is identical to the definition of the same term in Section 2(a)(1) of the Act.

Professional Standards

The definition of professional standards in Rule1001(p)(vi) references that in Section 2(a)(10) of the Act. It should be noted that the term "professional standards" is broader than "auditing and related professional practice standards," which is defined in Rule 1001(a)(viii) of the Board's rules.

Rule 4000 – General

Consistent with Section 104(a) of the Act, Rule 4000 subjects every registered public accounting firm to all such regular and special inspections as the Board may from time-to-time conduct in order to assess the degree of compliance of each registered public accounting firm and associated persons of that firm with the Act, the Board's rules, the rules of the Commission, and professional standards, in connection with its performance of audits, issuance of audit reports, and related matters involving issuers. The rule provides that inspection steps and procedures will be performed by the staff of the Division of Registration and Inspections and by such other persons authorized by the Board. The Board anticipates that "other persons authorized by the Board" to perform an inspection will include consultants and staff of the Board, other than staff of the Board's Division of Registration and Inspections.[1/] The Board does not anticipate that practicing accountants associated with public accounting firms will participate in the Board's inspections.

[1/] The Board anticipates using some consultants to supplement its permanent staff on certain inspections during its first cycle of inspections. All inspections will be led by a senior staff member of the PCAOB's Division of Registration and Inspections. Once the first cycle of inspections is complete and the Board has further added to its inspections staff, the Board anticipates that consultants will be primarily used as technical specialists, as needed, on discrete issues in the course of inspections. Non-staff that participate in the Board's inspections will be subject to relevant provisions of the Board's Ethics Code, including the same confidentiality requirements to which the Board's inspection staff is subject.

Rule 4001 – Regular Inspections

Rule 4001 requires that in performing a regular inspection, the staff of the Division of Registration and Inspections and other authorized persons take such steps and perform such procedures as the Board determines are necessary or appropriate. The rule requires the inclusion of steps and procedures set forth in Sections 104(d)(1) and (2) of the Act and such other tests of the audit, supervisory, and quality control procedures of the firm as the Director of the Division of Registration and Inspections or the Board determines.

Section 104(d)(1) requires the Board to "inspect and review engagements of the firm (which may include audit engagements that are the subject of ongoing litigation or other controversy between the firm and one or more third parties), performed at various offices and by various associated persons of the firm, as selected by the Board." Section 104(d)(2) requires the Board to "evaluate the sufficiency of the quality control system of the firm, and the manner of documentation and communication of that system by the firm."

Rule 4002 – Special Inspections

Rule 4002 requires that in performing a special inspection, the staff of the Division of Registration and Inspections and other authorized persons take such steps and perform such procedures, as are necessary or appropriate concerning the issue or issues specified by the Board in connection with its authorization of the special inspection. A note to the rule makes clear that under Section 104(b)(2) of the Act, the Board may authorize a special inspection on its own initiative or at the request of the Commission. Like any other Board action, the

vote of a majority of the Board members present at a meeting at which a quorum of Board members is present is required to authorize a special inspection.

In order to retain flexibility and to avoid a formulaic approach to such inspections, the Board has decided not to develop a set threshold or list of criteria that may lead to the commencement of a special inspection. For example, while the Board will consider the source of information it receives, the Board may find that in certain circumstances anonymous tips or media stories may be sufficient to begin a special inspection. Similarly, in order to retain flexibility, the Board has decided not to include a specific notice provision in the rule. As a practical matter, however, the Board's staff intends to give firms subject to special inspections reasonable notice in advance of commencing such inspections.

Special inspections are not intended to serve the same function as a Board investigation, which will be conducted pursuant to the Board's investigative rules and procedures. Special inspections are designed to address issues that come to the Board's attention and, as a general matter, will be performed in order to assess the degree of compliance of each registered public accounting firm and associated persons of that firm with the Act, the Board's rules, the rules of the Commission, and professional standards, in connection with its performance of audits, issuance of audit reports, and related matters involving issuers. Nevertheless, any inspection – whether a regular inspection or a special inspection – may result in a particular matter being turned over to the Board's enforcement staff for investigation.

Rule 4003 – Frequency of Inspections

Rule 4003 sets forth the schedule for regular inspections. Rule 4003(a) is consistent with the schedule for larger registered public accounting firms set forth in Section 104(b)(1)(A) of the Act. This rule requires that beginning no later than the year after its registration with the Board has been approved, a registered public accounting firm that, during the prior calendar year, issued audit reports with respect to more than 100 issuers will be subject to a regular inspection. Rule 4003(b) is consistent with the schedule for smaller registered public accounting firms set forth in Section 104(b)(1)(B) of the Act. Rule 4003(b) requires that beginning with the three-year period following the calendar year in which its registration with the Board has been approved, a registered public accounting firm that, during any of the three prior calendar years, issued audit reports with respect to at least one, but no more than 100, issuers, or that played a substantial role in the preparation or furnishing of an audit report with respect to at least one issuer, will be subject to a regular inspection.

In accordance with Section 104(b)(2) of the Act, the Board has added Rule 4003(c) which adjusts the regular inspection schedule for a registered public accounting firm that has requested to withdraw from registration by filing a completed Form 1-WD. Specifically, the rule provides that the Board shall have discretion not to conduct a regular inspection that would otherwise commence during the period beginning on the fifth day following the filing of the completed Form 1-WD and continuing until the firm's registration is deemed withdrawn or the firm withdraws its Form 1-WD.

The Board understands that firms that register with the Board will also have practices relating to audits other than public company audits, and that state regulatory requirements continue to involve a peer review process related to those practices. The Board expects its inspections staff to make any appropriate recommendations concerning coordination with such reviews as the staff gains experience with issues relating to the implementation of the Board's inspection responsibilities.

Rule 4004 – Procedure Regarding Possible Violations

Consistent with Section 104(c) of the Act, Rule 4004 sets forth procedures which the Board is required to follow with respect to possible violations by firms under inspection. Specifically, the rule requires that if the Board determines that information obtained by the Board's staff during any inspection indicates that the registered public accounting firm subject to such inspection, any associated person thereof, or any other person, may have engaged, or may be engaged in any act, practice, or omission to act that is or may be in violation of the Act, the rules of the Board, any statute or rule administered by the Commission, the firm's own quality control policies, or any professional standard, then the Board shall, if it determines it appropriate, report such possible violations to the Commission and each appropriate state regulatory authority. In addition, under Rule 4004, if the Board determines it appropriate, the Board shall commence an investigation of such act, practice, or omission in accordance with Section 105(b) of the Act and the Board's rules thereunder or commence a disciplinary proceeding in accordance with Section 105(c) of the Act and the Board's rules thereunder.

The phrase "if it determines appropriate" in Rule 4004 is meant to signal that the Board will decide which of these acts, practices and omissions would be appropriate to refer to the Commission and to the states or other authorities. In making this determination, depending on the nature of the possible violation, the Board could conclude that it may be appropriate to report information to the Commission, and not the states or other authorities, and vice versa.

A note to the rule makes clear that the Board may, as appropriate, report information and make referrals to agencies other than those specifically described in Rule 4004. The Note is intended to provide notice that Rule 4004, in implementing Section 104(c) of the Act, should not be understood as precluding the Board from exercising the Board's other statutory authority to make referrals or to report information from inspections. Neither the rule nor the note are intended to describe the limit of that authority.

Rule 4005 – Record Retention and Availability

Section 104(e) of the Act provides that the "rules of the Board may require the retention by registered public accounting firms for inspection purposes of records whose retention is not otherwise required by Section 103 or the rules issued thereunder." The Board is reserving this rule in anticipation of issuing standards on record retention once it has experience with its inspection program.[2/] The Board reminds registered public accounting firms that they

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[2/] The Board anticipates that standards concerning record retention will continue to be codified in the standards sections of the Board's rules. Any future Rule 4005 on record retention and availability for inspections will supplement those standards.

should continue to comply with all other applicable federal, state and professional record retention requirements.

Rule 4006 – Duty to Cooperate with Inspectors

Rule 4006 requires every registered public accounting firm and every associated person of such firm to cooperate with the Board in any Board inspection. The rule requires that such firms and persons must cooperate and comply with any request, made in furtherance of the Board's authority and responsibilities under the Act, for documents or information. Like Section 102(b)(3) of the Act, the rule describes the required cooperation in terms of cooperating and complying with any request "made in furtherance of the Board's authority and responsibilities under the Act."

Rule 4006 is intended to provide for Board access to documents and information to the full extent authorized by the Act. Among other things, that means that the scope of the rule is not limited to documents and information generated in the course of audits of issuers. Under Section 104(d) of the Act, Board inspections involve evaluations and testing of, among other things, a firm's quality control and supervisory procedures. Accordingly, the documents and information the Board is likely to request as part of its authority and responsibilities to inspect registered public accounting firms, and that therefore a firm must cooperate by providing access to, will involve more than documents and information generated in the course of audits of issuers.

The Act provides that, in general, "all documents and information prepared or received by or specifically for the Board, and deliberations of the Board and its

employees and agents, in connection with an inspection under section 104 . . . shall be confidential and privileged as an evidentiary matter (and shall not be subject to civil discovery or other legal process) in any proceeding in any Federal or State court or administrative agency . . . ." Accordingly, documents and information received by the Board pursuant to Rule 4006 in connection with a Section 104 inspection are entitled to this statutory protection. In addition, as discussed in more detail in the Board's release adopting its investigation and adjudication rules,[3/] the Board intends to recognize certain privileges recognized elsewhere in the law – specifically, privileges that, under prevailing law, would constitute a valid basis for declining to comply with a Commission subpoena. As explained in more detail in that release, however, the Board will not honor assertions of an "accountant-client" privilege. More generally, any perceived state law or professional nondisclosure requirements or other obstacles to cooperation (other than a privilege that would be a valid basis for resisting a Commission subpoena) are, in the Board's view, preempted by the Act. Accordingly, a failure to cooperate with a Board inspection on the basis of such requirements would be a violation of Rule 4006.

Rule 4007 – Procedures Concerning Draft Inspection Reports

Rule 4007 describes procedures relating to a registered public accounting firm's opportunity to review and comment on a draft inspection report before the Board issues a final inspection report concerning the firm. Rule 4007(a) provides

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[3/] PCAOB Release No. 2003-016, at pages A2-33 - A2-34 (Sept. 29, 2003).

that the Director of the Division of Registration and Inspections will make a draft report available for review by the firm that is the subject of the report. Paragraph (a) provides that a firm then has 30 days, or such longer period as the Board may order, in which to submit any written response that the firm wishes to submit to the draft. A firm is not required to submit a response, and any response that a firm chooses to submit may include any comments, objections, recommended revisions, or other views on the draft report.

Rule 4007(b) concerns requests that a firm may make for confidential treatment of portions of its response to the draft. Rule 4007(b)(1) provides that a firm may request confidential treatment under Section 104(f) of the Act for any portion of the firm's response to the draft report and may supply any supporting authority or other justification for according confidential treatment to the specified information. Rule 4007(b)(2) implements Section 104(f)'s requirement that the Board shall attach to, and make part of, the inspection report, any response submitted by the firm. Further implementing Section 104(f), Rule 4007(b)(2) provides that the version of the response that becomes part of the inspection report will be redacted to exclude any information for which the firm requested confidential treatment and which it is reasonable to characterize as confidential.

The Section 105(b)(5)(A) confidentiality protection extends to documents "received by" the Board and to documents "prepared . . . specifically for" the Board. The response that a firm provides to the Board falls into both of those categories. The Board will therefore maintain the response as confidential

except to the extent that the Act expressly allows or requires the Board to disclose it.

The Act expressly allows or requires the Board to disclose the firm's response in at least three ways. First, Section 104(f) of the Act requires that the text of the firm's response must be attached to and made part of the inspection report. As part of the inspection report, the response will become public if and when the relevant portion of the report becomes public. Second, Section 104(g)(1) of the Act requires that the Board transmit the firm's response to the Commission and to appropriate state regulatory authorities when the Board transmits the final report to them. Third, Section 105(b)(5)(B) allows the Board to transmit to the regulatory and law enforcement agencies specified there any materials covered by Section 105(b)(5)(A), which would include the firm's response to the draft.

Any confidential treatment that the Board grants pursuant to a firm's request under Section 104(f) would restrict disclosure of the information only in the context of the first of those three possibilities – the inclusion of the response as part of the inspection report. The only consequence of the confidential treatment afforded under Section 104(f) is that the Board will redact the confidential information from the version of the response that is attached to and made part of the inspection report. Accordingly, if the portion of the final report that includes the response eventually becomes public, it will not include any

information granted confidential treatment under Section 104(f).[4/] In the second and third contexts described in the preceding paragraph, however, nothing in Section 104(f) operates to limit what the Board may disclose to certain regulatory and law enforcement agencies.

Rule 4007(c) provides that after receiving the firm's response, the Board has various options. The rule permits the Board to take such action with respect to the draft report as it considers appropriate. For example, the Board may adopt the draft report as the final report, revise the draft report, or continue or supplement the inspection before issuing a final report. If the Board directs the staff to continue or supplement the inspection or revise the draft report, the Board may, in its discretion, afford the firm the opportunity to review any revised draft inspection report. Rule 4007(c) permits the Board, in its discretion, to afford firms a second opportunity to comment on an inspection report when the Board continues or supplements its inspection or revises a draft report after receiving a firm response. The Board intends to afford registered firms an opportunity to comment on revised reports when new findings or assessments have been made or, more generally, when significant changes have been made to the draft report by the Board.

[4/] For example, if the firm's response is directed to the portion of the report that deals with quality control defects, the response will not be made public for as long as that portion of the report is not made public. That portion of the report may be made public, however, if the firm fails to address the criticisms to the Board's satisfaction within 12 months. At that time, that portion of the report, including the firm's response, would be made public, but any part of the response that had received confidential treatment under Section 104(f) would be redacted from the report that is made public.

Rule 4008 – Procedures Concerning Final Inspection Reports

Rule 4008 describes procedures related to a final inspection report. Rule 4008(a) provides that the Board will make a final inspection report available for review by the firm that is the subject of the report. As is true of draft inspection reports under Rule 4007, Rule 4008 requires that the Board make the final report available for the firm's review, but the Board need not necessarily allow the firm to have and maintain its own copy of the full report. Rule 4008(b) provides that the Board will transmit the final report to the Commission, along with any additional letter or comments by the Board or the Board's inspectors and along with the firm's response to any draft of the report. Rule 4008(c) provides that the Board will transmit to each appropriate state regulatory authority, in appropriate detail, the final report, any additional letter or comments by the Board or inspectors, and the firm's response to any draft of the report. The Act leaves to the Board's discretion the determination of what detail is or is not appropriate for reporting to a state regulator. The rule allows the Board the flexibility to exercise that discretion.

Section 104(g)(1) of the Act requires that the Board transmit the final report "in appropriate detail, to the Commission and each appropriate State regulatory authority, accompanied by any letter or comments by the Board or the inspector, and any letter of response from the registered public accounting firm." Rules 4008(b) and 4008(c) implement that provision of the Act.

A final inspection report is a document prepared by the Board in connection with an inspection, and would therefore generally be covered by

Section 105(b)(5)(A)'s confidentiality protection. A final inspection report is also likely to contain substantial information "received by" the Board in connection with an inspection, and that is independently subject to the protection of 105(b)(5)(A), as the Act explicitly notes in Section 104(g)(2).[5/] A final inspection report is also unique, however, in that the Act separately contemplates, in Section 104(g)(2), that at least some portions of it will be publicly available.

The Act plainly does not require that a state regulator maintain the confidentiality of any portion of a final report that becomes publicly available pursuant to Section 104(g)(2). Any other portion of the final report, however, as well as any letter that accompanies the transmittal and any copy of the firm's response to a draft report, are subject to the protection of Section 105(b)(5)(A) and, as a consequence, a state regulator receives them subject to Section 105(b)(5)(B)'s express requirement to maintain them as confidential and privileged. Moreover, with respect to portions of the final report that address quality control defects, state regulatory authorities are equally bound by Section 104(g)(2)'s command that such portions of the report shall not be made public unless the firm fails to do certain things within 12 months of the report's issuance.[6/] Any otherwise applicable state or local law that conflicts with this

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[5/] See Section 104(g)(2) (noting that disclosure of reports to public is "subject to section 105(b)(5)(A)").

[6/] The Act does not prohibit a firm from voluntarily disclosing or providing a report or any portion of a report to any person.

requirement or stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress would be preempted.[7/]

Rule 4009 – Firm Response to Quality Control Defects

Consistent with Section 104(g)(2) of the Act, when a final inspection report contains any discussion of criticisms of, or potential defects in, the firm's quality control systems, Rule 4009(a) permits the firm to submit evidence or otherwise to demonstrate to the Director of the Division of Registration and Inspections that it has improved such quality control systems, and remedied such defects. This submission or demonstration must be made no later than 12 months after the issuance of the Board's final inspection report. The date of issuance will be the date the final inspection report is adopted by the Board as final. Absent extraordinary circumstances, the report will be available for review by the firm beginning on that date. The rule requires the Director, after reviewing the evidence, to advise the firm whether he or she will recommend to the Board that the firm has satisfactorily addressed the criticisms or defects in the quality control system of the firm identified in the final inspection report and, if not, why not.

Rule 4009(b) provides that if the Board determines that the firm has satisfactorily addressed all quality control defects and criticisms in the final report, the Board will promptly provide notice of that determination to the Commission and to any appropriate state regulatory authority to which the Board had provided any portion of the final inspection report.

[7/] See Crosby v. National Foreign Trade Council, 530 U.S. 363, 372-73 (2000); City of New York v. FCC, 486 U.S. 57, 64 (1988).

Rule 4009(c) requires the Board to notify the firm of its final determination as to whether the firm has addressed to the satisfaction of the Board the criticisms or defects in the firm's quality control system.

Rule 4009(d) provides that the Board will make public those portions of a final inspection report dealing with such criticisms and defects if the firm fails to address those matters to the Board's satisfaction within 12 months of the issuance of the final inspection report. Rule 4009(d) specifically addresses the time of any such public disclosure. Under Rule 4009(d), if a firm made no submission to the Board under Rule 4009(a) concerning the firm's efforts to address the criticisms or potential defects, then the Board would make those portions of the report public upon the expiration of the 12-month period. If the firm made a submission under Rule 4009(a), but then failed to seek Commission review of an adverse Board determination concerning that submission within the time allowed to seek such review, the Board would make those portions of the report public upon the expiration of the period allowed for seeking Commission review.

If the firm did timely seek Commission review, under Section 104(h)(1)(B) of the Act, of an adverse Board determination, the Board would make those portions of the report public 30 days after the firm formally requested Commission review, unless the Commission, by rule or order, directs otherwise. The Board is adopting a 30-day delay, subject to any superseding Commission rule or order, to allow the Commission an opportunity to consider whether to

order a longer stay of public disclosure in a particular case, since the Act does not operate to stay such disclosure.

Rule 4010 – Board Public Reports

Rule 4010 permits the Board, at any time, to publish public summaries, compilations, or other general reports concerning the procedures, findings, and results of its various inspections as the Board deems appropriate. The rule allows for these reports to include discussion of criticisms of, or potential defects in, quality control systems of any firm or firms that were the subject of a Board inspection. However, the rule prohibits these published reports from identifying the firm or firms to which these criticisms relate, or at which the defects were found, unless the information has previously been made public pursuant to the Board's rules or other lawful means. The phrase “other lawful means” refers to situations in which the covered information is made public by lawful means provided for in the Act.

(b) Statutory Basis

The statutory basis for the proposed rules is Title I of the Act.

B. Board's Statement on Burden on Competition

The Board does not believe that the proposed rules will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The proposed rules provide a procedural framework for the program of continuing inspections that the Act requires the Board to conduct. With respect to the firms to be inspected, the proposed rules impose no burden beyond the burdens clearly imposed and contemplated by the Act.

C. Board's Statement on Comments on the Proposed Rules Received from Members, Participants or Others

The Board released the proposed rules for public comment in PCAOB Release No. 2003-013 (July 28, 2003). A copy of PCAOB Release No. 2003-013 and the comment letters received in response to the PCAOB's request for comment are available on the PCAOB's web site at www.pcaobus.org. The Board received 16 written comments. The Board has clarified and modified certain aspects of the proposed rules in response to comments it received, as discussed below.

To address one commenter's concern about the scope of the Board's inspections, the Board clarified in the rule that registered public accounting firms will be subject to regular and special inspections "in order to assess the degree of compliance of each registered public accounting firm and associated persons of that firm with the Act, the Board's rules, the rules of the Commission, and professional standards, in connection with its performance of audits, issuance of audit reports, and related matters involving issuers."

One commenter was confused by, and asked the Board to explain, the provisions of the proposed rule that stated that, at the conclusion of each inspection, the Director would submit a draft report to the Board and then, unless the Board directed that transmittal be deferred, transmit the draft report to the firm under review. This part of the rule only described internal Board procedures. To eliminate any confusion created by this provision and to preserve the Board's flexibility to structure its internal processes, the Board deleted these provisions from the rule.

The Board also made a change concerning the amount of time within which the rule requires a firm to submit a response to a draft inspection report. Commenters suggested that the proposed period, 30 days, was too short. The Board believes that, as a general matter, 30 days allows sufficient time, but the Board added a provision that would allow the Board to grant a longer period when warranted by unusual circumstances.

One commenter suggested that the rules should more closely track the Act by expressly providing that a firm's response to a draft inspection report would be attached to, and made part of, any final report. The Board incorporated such a provision in the final rules.

One commenter noted that the Board's description of the state authorities that would receive the final inspection report under Rule 4008, as proposed, differed slightly from the authorities described in the Act's definition of "appropriate state regulatory authority." In response to this comment, the Board changed its rule to more closely track the Act. Specifically, the Board added a definition of "appropriate state regulatory authority" based on the definition of that term in the Act. The Board expects that, in most cases, the appropriate state regulatory authority to receive an inspection report will be any state, agency, board or other authority that has issued a license or certification number authorizing the firm to engage in the business of auditing or accounting.

Finally, one commenter suggested that the Board notify the Commission and each appropriate state regulatory authority to which the final inspection report was provided under Rule 4008(b) and (c) of the Board's final determination

concerning whether the firm has addressed the criticisms or defects in the quality control system of the firm identified in the inspection report to the satisfaction of the Board. The Board implemented this suggestion by adding paragraph (b) to Rule 4009. Rule 4009(b) provides that if the Board determines that the firm has satisfactorily addressed all quality control defects and criticisms in the final report, the Board will promptly provide notice of that determination to the Commission and to any appropriate state regulatory authority to which the Board had provided any portion of the final inspection report.

III. Date of Effectiveness of the Proposed Rules and Timing for Commission Action

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Board consents the Commission will:

(a) by order approve such proposed rules; or

(b) institute proceedings to determine whether the proposed rules should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rules are consistent with the requirements of Title I of the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. Copies of the

submission, all subsequent amendments, all written statements with respect to the proposed rules that are filed with the Commission, and all written communications relating to the proposed rules between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the PCAOB. All submissions should refer to File No. PCAOB-2003-08 and should be submitted within [ ] days.

By the Commission.

Secretary

PCAOB
Public Company Accounting Oversight Board

1666 K Street, N.W.
Washington, DC 20006
Telephone: (202) 207-9100
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PROPOSED RULES ON INSPECTIONS OF REGISTERED PUBLIC ACCOUNTING FIRMS	PCAOB Release No. 2003-013 July 28, 2003 PCAOB Rulemaking Docket Matter No. 006

Summary: The Public Company Accounting Oversight Board (the "Board" or "PCAOB") has proposed rules on inspections of registered public accounting firms. Section 104(a) of the Sarbanes-Oxley Act of 2002 (the "Act") directs the Board to conduct a continuing program of inspections to assess the degree of compliance of each public accounting firm registered with the Board, and that firm's associated persons, with the Act, the rules of the Board, the rules of the Securities and Exchange Commission (the "Commission"), and professional standards in connection with the performance of audits, the issuance of audit reports, and related matters involving U.S. public companies. The proposal consists of 10 rules (PCAOB Rules 4000 through 4010) plus a related definition. The Board is seeking comment on its proposed rules by August 18, 2003. The Board will then consider the comments, modify its proposal as it deems appropriate, and submit the proposal to the Commission for its approval pursuant to Section 107 of the Act. The Board's inspection rules will not take effect unless approved by the Commission.

Public Comment: Interested persons may submit written comments to the Board. Such comments should be sent to the Office of the Secretary, PCAOB, 1666 K Street, N.W., Washington, D.C. 20006-2803. Comments may also be

submitted by e-mail to comments@pcaobus.org or through the Board's Web site at www.pcaobus.org. All comments should refer to PCAOB Rulemaking Docket Matter No. 006 in the subject or reference line and should be received by the Board no later than 5:00 PM (EDT) on August 18, 2003.

Board Contacts: Chris Mandaleris, Deputy Director – Inspections (202/207-9057; mandalerisc@pcaobus.org), Michael Stevenson, Associate General Counsel (202/207-9054; stevensonm@pcaobus.org), or Phoebe Brown, Special Counsel to Board Member Goelzer (202/207-9073; brownp@pcaobus.org).

* * *

Section 104(a) of the Act directs the Board to conduct a continuing program of inspections to assess the degree of compliance of each registered public accounting firm and associated persons of that firm with the Act, the Board's and the Commission's rules, and professional standards in connection with the performance of audits, the issuance of audit reports, and related matters involving U.S. public companies.[1/] Section 101(c)(3) of the Act provides that the Board shall "conduct inspections of registered public accounting firms, in accordance with section 104 and the rules of the Board." To implement this directive and to comply with Section 101(c)(3), the Board has proposed rules relating to inspections, which are summarized below in Section A of this release.[2/]

[1/] This release uses the term "U.S. public companies" as shorthand for the companies that are "issuers" under the Act and the Board's rules. This includes domestic public companies, whether listed on an exchange or not, and foreign private issuers that have either registered, or are in the process of registering, a class of securities with the Commission or are otherwise subject to Commission reporting requirements.

[2/] The proposed rules govern procedural matters concerning the Board's inspection program. Board staff will carry out particular inspections according to detailed, nonpublic inspection plans.

The Board seeks the views of interested persons on the proposed inspection rules. Section B of this release describes how comments and views may be submitted to the Board. The Board's proposal consists of 10 rules (PCAOB Rules 4000 through 4010) plus a related definition. The text of these rules and a detailed discussion of each of the rules are attached as Appendices 1 and 2, respectively.

A. Overview of the Board's Inspections Rules

1. The Board's staff will conduct regular and special inspections of registered public accounting firms.

Consistent with Section 104(a) of the Act, the Board's proposed rules subject public accounting firms that are registered with the Board to regular and special inspections as the Board may from time-to-time conduct.[3/] Section 104(b)(1) requires inspections to be conducted "annually with respect to each registered public accounting firm that regularly provides audit reports for more than 100 issuers; and * * * not less frequently than once every three years with respect to each registered public accounting firm that regularly provides audit reports for 100 or fewer issuers." Further, Section 104(b)(2) provides that "the Board may conduct special inspections at the request of the Commission or upon its own motion." To implement Section 104(b) of the Act, the Board has proposed two types of inspections – those conducted on a regularly scheduled basis, or "regular inspections" and those conducted at the request of the Board or the Commission, or "special inspections."[4/]

In conducting an inspection, Section 104(d) of the Act directs the Board to take the following steps: (1) inspect and review selected audit and review engagements of the firm (which may include audit engagements that are the subject of ongoing litigation or other controversy between the firm and one or more third parties) performed at various offices and by various associated persons of the firm,[5/] as selected by the

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[3/] Rule 4000.

[4/] Rules 4001 and 4002.

[5/] The Board's Rule 1001(p)(i) defines "associated person of a public accounting firm" as "any individual proprietor, partner, shareholder, principal,

Board, (2) evaluate the sufficiency of the quality control system of the firm, and the manner of documentation and communication of that system by the firm, and (3) perform such other testing of the audit, supervisory and quality control procedures of the firm as are necessary or appropriate in light of the purpose of the inspection and the responsibilities of the Board.[6/]

Consistent with Section 104(d), the Board's proposed rules provide that a regular inspection will include, but is not limited to, the steps and procedures as specified in Sections 104(d)(1) and (2) of the Act and any other tests of the audit, supervisory, and quality control procedures of the firm as the Director of the Division of Registration and Inspections or the Board determines appropriate.[7/] In addition, proposed Rule 4002 provides for special inspections that will include all steps and procedures necessary or appropriate to address the issue or issues raised by the Board when it authorized the inspection.[8/]

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accountant, or professional employee of a public accounting firm, or any independent contractor that, in connection with the preparation or issuance of any audit report –

(1) shares in the profits of, or receives compensation in any other form from, that firm; or

(2) participates as agent on behalf of such accounting firm in any activity of that firm;

provided, however, that these terms do not include a person engaged only in clerical or ministerial tasks or a person whom the public accounting firm reasonably believes is a person primarily associated with another registered public accounting firm."

[6/] See Sections 104(d)(1), (2) and (3) of the Act.

[7/] Rule 4001.

[8/] Rule 4002.

2. In general, the Board's staff will conduct regular inspections either annually or triennially and special inspections as appropriate to address issues that come to the Board's attention.

Consistent with Sections 104(b)(1) and (2) of the Act, the frequency of the regular inspections will depend on the number of U.S. public companies for which the registered public accounting firm issues or plays a substantial role in the preparation or furnishing of audit reports. Specifically, Section 104(b)(1) of the Act provides that "inspections * * * be conducted * * * annually with respect to each registered public accounting firm that regularly provides audit reports for more than 100 issuers * * * and not less frequently than once every 3 years with respect to each registered public accounting firm that regularly provides audit reports for 100 or fewer issuers." Furthermore, Section 104(b)(2) of the Act provides that the Board may, by rule, adjust the statutory inspection schedule in Section 104(b)(1), if it finds that "different inspection schedules are consistent with the purpose of the Act, the public interest and protection of investors."

Consistent with Section 104(b)(1) of the Act, the Board has proposed the following inspection schedule –

- Beginning no later than the year after its registration with the Board has been approved, a registered public accounting firm that issued audit reports for more than 100 U.S. public companies will be subject to an annual regular inspection.[9/]

- Beginning with the three-year period following the calendar year in which its registration with the Board has been approved, a registered public accounting firm that issued audit reports for at least one, but no more than 100 U.S. public companies, or that played a substantial role in the preparation or furnishing of audit reports for any U.S. public companies, will be subject to regular inspection once every three years.[10/]

[9/] Rule 4003(a). The frequency of a firm's regular inspections will be determined according to the volume of its relevant audit-related work in the preceding year.

[10/] Rule 4003(b).

Section 104(b)(2) of the Act authorizes the Board to adjust the statutory inspection schedule if such adjustments are consistent with the purposes of the Act, the public interest, and the protection of investors. The proposed rules would make such an adjustment in the case of two classes of registered public accounting firms – (1) those that have voluntarily registered with the Board and do not issue, or play a substantial role in the preparation or furnishing of, a U.S. public company audit report, and (2) those that are registered with the Board but have pending before the Board a request for leave to withdraw their registration. For the reasons explained below, the Board has found that the proposed adjustments to the statutory inspection schedule are necessary to take into account the nature of the practice of these firms and that the adjustments meet the requirements of Section 104(b)(2).

In the case of registered firms that do not engage in public company auditing, the Board does not believe that inspections would accomplish the objectives of the Act. Section 104(c) directs the Board to design its inspection program to assess compliance in connection with a firm's performance of U.S. public company audits, the issuance of U.S. public company audit reports, and related matters involving U.S. public companies. These goals could not be accomplished if the firm under inspection does not participate in public company audits. Therefore, the Board believes that it is consistent with the Act and in the public interest not to subject such a firm to a regular inspection until the firm actually becomes involved in the business of issuing, or playing a substantial role in the preparation or furnishing of, audit reports for a U.S. public company. For this reason, Rule 4003 is silent with respect to any schedule for regular inspections of firms with no public company audit clients.[11/]

In the case of registered firms that are seeking to withdraw from registration, similar reasoning applies. Under the Board's separately proposed rule relating to withdrawal from registration, such a firm would be designated as "registered –

[11/] The Board does not encourage the registration of firms that have no public company clients and are not actively seeking to develop a public company clientele. In the future, the Board may consider requiring de-registration of firms that, for an extended period, do not audit, or play a substantial role in the audit of, any public company and do not engage in any other activity that requires registration. See "Frequently Asked Questions Regarding Registration With the Board," Question #8 (July 18, 2003).

withdrawal request pending" and would not be permitted to issue or play a substantial role in the issuance of U.S. public company audit reports. The Board believes that it would be consistent with the Act and in the public interest for the Board to exercise discretion in determining whether to commence a regular inspection of a firm that has filed a Form 1-WD, rather than strictly hold the firm to the same inspection schedule as other registered firms.

Special inspections are not subject to an inspection schedule and will be conducted at such time as is necessary or appropriate to address issues that come to the Board's attention.[12/] The Board expects that special inspections may be commenced, based on information that comes to the attention of the Board or its staff in any way, including public company filings with the Commission, news reports and matters brought informally to the attention of the Board's staff by other regulators, professional associations, informants, and members of the public. A registered public accounting firm may be subject to a special inspection irrespective of the timing of such firm's regular inspection schedule.

3. The Board may refer information learned in inspections to other authorities and may commence an investigation or disciplinary proceeding on the basis of such information.

Section 104(c) of the Act requires the Board to promulgate rules on procedures regarding possible violations. Specifically, Section 104(c) states that "[t]he Board shall, in each inspection * * * and in accordance with its rules for such inspection: (1) identify any act or practice or omission to act by the registered public accounting firm, or by any associated person thereof, revealed by such inspection that may be in violation of [the] Act, the rules of the Board, the rules of the Commission, the firm's own quality control policies, or professional standards; (2) report any such act, practice, or omission, if appropriate, to the Commission and each appropriate State regulatory authority; and (3) begin a formal investigation or take disciplinary action, if appropriate, with respect to any such violation, in accordance with [the] Act and the rules of the Board."

To implement Section 104(c) of the Act, the Board is proposing Rule 4004. Under Rule 4004, if the Board determines that an inspection of a registered public accounting firm reveals a possible violation as described in Section 104(c) by the

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[12/] Rule 4002.

registered public accounting firm, any of its associated persons, or any other person, the Board will, if appropriate (1) report the possible violation to the Commission and each state or other authority that has issued a license or certification number authorizing such person or firm to engage in the business of auditing or accounting, and (2) commence an investigation or a disciplinary proceeding in accordance with the Act and under its rules. Reporting to the Commission and relevant licensing or certification authorities will be subject to Section 105(b)(5)(B) of the Act, which provides that the information provided by the Board shall maintain its status as confidential and privileged in the hands of both the Board and the agency to which the Board reports it. Rule 4004 specifically implements Section 104(c) of the Act. Section 104(c), however, does not limit the Board's authority to refer information, as appropriate, to other authorities not specified in Section 104(c), such as those other authorities identified in Section 105(b)(5)(B). Accordingly, a note to Rule 4004 indicates that the Board may also make referrals other than those to the Commission and relevant licensing or certification authorities.[13/]

4. The Board and its staff will prepare an inspection report in connection with an inspection.

To implement Sections 104(f) and (g) of the Act, the Board has proposed rules that provide that at the conclusion of an inspection, the Director of the Division of Registration and Inspections will submit to the Board a written draft inspection report. These rules also set forth the process by which a draft inspection report will be submitted to a firm under review in order that the firm may submit any comments or other views concerning the draft report. After reviewing any such submission, the Board will issue a final inspection report.[14/] The firm's response to the draft inspection report shall be attached to and made part of the inspection report. Section 104(g)(2) of the Act requires the Board to make final inspection reports available to the public in appropriate detail, subject to specific exclusions for confidential and proprietary information, information shielded by Section 105(b)(5)(A) of the Act, and portions of the report dealing with criticisms or potential defects in the quality control systems of the firm under inspection.

[13/] Rule 4004.

[14/] Rules 4007(b) and (c).

5. Quality control defects or criticisms described in an inspection report will not be made public if the firm addresses them to the Board's satisfaction within 12 months of the report.

If an inspection report includes criticisms of, or describes potential defects in, a firm's quality control systems, those portions of the inspection report may be made public only if the firm fails to address those matters to the Board's satisfaction within 12 months of the issuance of the final inspection report. Consistent with Section 104(g)(2), proposed Rule 4009 provides that, no later than 12 months after the issuance of the Board's final inspection report, firms may submit to the Director of the Division of Registration and Inspections evidence that they have improved such quality control systems, and remedied such defects. After reviewing such evidence, the Director must advise the firm whether he or she will recommend to the Board that the firm has satisfactorily addressed the criticisms or defects in the quality control system of the firm identified in the final inspection report and, if not, why not.[15/]

6. The Board may publish reports concerning the procedures, findings, and results of its inspections generally.

Under the proposed rules, the Board may, at any time, publish summaries, compilations, and general reports concerning the procedures, findings, and results of its various inspections. These reports may include discussion of criticisms of, or potential defects in, quality control systems of any firm or firms that were the subject of a Board inspection. Under the proposed rules, these published reports will not identify the firm or firms to which these criticisms relate, or at which the defects were found, unless the information has previously been made public pursuant to the Board's rules or other lawful means.[16/]

7. Special Issues Relating to Non-U.S. Firms

The rules proposed today apply to inspections of registered public accounting firms. Non-U.S. public accounting firms are not required to be registered until April 19, 2004. As the Board has previously announced, the nature and scope of the Board's oversight over non-U.S. accounting firms that audit the financial statements of U.S.

[15/] Rule 4009(a).

[16/] Rule 4010.

public companies will be the subject of dialogue between the Board and its foreign counterparts. The Board is committed to finding ways of accomplishing the goals of the Act without subjecting non-U.S. firms to unnecessary burdens or conflicting requirements. The Board's proposed rules are not intended in any way to signal that the Board has already determined how its oversight should operate as to those firms, or to preclude any adjustments to the rules that may be appropriate in light of those discussions.

B. Opportunity for Public Comment

Interested persons are encouraged to submit their views to the Board. Written comments should be sent to the Office of the Secretary, PCAOB, 1666 K Street, N.W., Washington, D.C. 20006-2803. Comments may also be submitted by e-mail to comments@pcaobus.org or through the Board's Web site at www.pcaobus.org. All comments should refer to PCAOB Rulemaking Docket Matter No. 006 in the subject or reference line and should be received by the Board no later than 5:00 PM (EDT) on August 18, 2003.

* * *

On the 28th day of July, in the year 2003, the foregoing was, in accordance with the bylaws of the Public Company Accounting Oversight Board,

ADOPTED BY THE BOARD.

/s/ J. Gordon Seymour
Acting Secretary

July 28, 2003

APPENDICES –

1. Proposed Rules Relating to Inspections

2. Section-by-Section Analysis of Proposed Inspection Rules

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Appendix 1 – Proposed Rules Relating to Inspections

RULES OF THE BOARD

SECTION 1. GENERAL PROVISIONS

Rule 1001. Definitions of Terms Employed in Rules.

When used in Rules, unless the context otherwise requires:

(p)(iv) Professional Standards

The term "professional standards" means –

(A) accounting principles that are –

(i) established by the standard setting body described in section 19(b) of the Securities Act of 1933, as amended by the Act, or prescribed by the Commission under section 19(a) of the Securities Act of 1933 or section 13(b) of the Securities Exchange Act of 1934; and

(ii) relevant to audit reports for particular issuers, or dealt with in the quality control system of a particular registered public accounting firm; and

(B) auditing standards, standards for attestation engagements, quality control policies and procedures, ethical and competency standards, and independence standards (including rules implementing Title II of the Act) that the Board or the Commission determines –

(i) relate to the preparation or issuance of audit reports for issuers; and

(ii) are established or adopted by the Board under section 103(a) of the Act, or are promulgated as rules of the Commission.

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SECTION 4. INSPECTIONS

Rule 4000. General.

Every registered public accounting firm shall be subject to all such regular and special inspections as the Board may from time-to-time conduct. Inspection steps and procedures shall be performed by the staff of the Division of Registration and Inspections, and by such other persons as the Board may authorize to participate in particular inspections or categories of inspections.

Rule 4001. Regular Inspections.

In performing a regular inspection, the staff of the Division of Registration and Inspections and any other person authorized by the Board to participate in the inspection shall take such steps, and perform such procedures, as the Board determines are necessary or appropriate in order to assess the degree of compliance of each registered public accounting firm and associated persons of that firm with the Act, the Board's rules, the rules of the Commission, and professional standards, in connection with its performance of audits, issuance of audit reports, and related matters involving issuers. Such steps and procedures must include, but need not be limited to, those set forth in Section 104(d)(1) and (2) of the Act and such other tests of the audit, supervisory, and quality control procedures of the firm as the Director of the Division of Registration and Inspections or the Board determines.

Rule 4002. Special Inspections.

In performing a special inspection, the staff of the Division of Registration and Inspections and any other person authorized by the Board to participate in the inspection shall take such steps, and perform such procedures, as are necessary or appropriate concerning the issue or issues specified by the Board in connection with its authorization of the special inspection.

Note: Under Section 104(b)(2) of the Act, the Board may authorize a special inspection on its own initiative or at the request of the Commission.

Rule 4003. Frequency of Inspections.

(a) During each calendar year, beginning no later than the calendar year following the calendar year in which its application for registration with the Board is approved, every registered public accounting firm that, during the prior calendar year, issued audit reports with respect to more than 100 issuers shall be subject to a regular inspection.

(b) At least once in every three calendar years, beginning with the three-year period following the calendar year in which its application for registration with the Board is approved, every registered public accounting firm that, during any of the three prior calendar years, issued an audit report with respect to at least one, but no more than 100, issuers, or that played a substantial role in the preparation or furnishing of an audit report with respect to at least one issuer, shall be subject to a regular inspection.

(c) With respect to a registered public accounting firm that has filed a completed Form 1-WD under Rule 2107, the Board shall have the discretion to forego any regular inspection that would otherwise commence during the period beginning on the fifth day following the filing of the completed Form 1-WD and continuing until the firm's registration is deemed withdrawn or the firm withdraws the Form 1-WD.

Rule 4004. Procedure Regarding Possible Violations.

If the Board determines that information obtained by the Board's staff during any inspection indicates that the registered public accounting firm subject to such inspection, any associated person thereof, or any other person, may have engaged, or may be engaged, in any act, practice, or omission to act that is or may be in violation of the Act, the rules of the Board, any statute or rule administered by the Commission, the firm's own quality control policies, or any professional standard, the Board shall, if it determines appropriate –

(a) report information concerning such act, practice, or omission, subject to the provisions of Section 105(b)(5)(B) of the Act, to –

(1) the Commission; and

(2) each state, agency, board, or other authority that has issued a license or certification number to the firm or person who engaged, or may have engaged, in such act, practice, or omission authorizing such firm or person to engage in the business of auditing or accounting; and

(b) commence an investigation of such act, practice, or omission in accordance with Section 105(b) of the Act and the Board's rules thereunder or a disciplinary proceeding in accordance with Section 105(c) of the Act and the Board's rules thereunder.

Note: The Board may, as appropriate, make referrals other than those specifically described in Rule 4004.

Rule 4005. Record Retention and Availability.

[Reserved]

Rule 4006. Duty to Cooperate With Inspectors.

Every registered public accounting firm, and every associated person of a registered public accounting firm, shall cooperate with the Board in the performance of any Board inspection. Cooperation shall include, but is not limited to, providing access to, and the ability to copy, any record in the possession, custody, or control of such firm or person and providing, by oral interview, written response, or otherwise, such other information as may be requested by the Board's inspectors and that the Board considers relevant or material to the subject matter of the inspection.

Rule 4007. Procedures for Firm Review of and Response to Draft Inspection Report and Issuance of Final Inspection Report.

(a) At the conclusion of each inspection, the Director of the Division of Registration and Inspections shall submit to the Board a written draft inspection report.

(b) Unless the Board directs that transmittal be deferred, the Director shall transmit the draft report to the firm under review. The firm may, within the 30 days following transmittal of the draft inspection report, submit to the Board by letter a

response to the draft report. Any portion of the firm's response that the firm believes is confidential within the meaning of the last sentence of Section 104(f) of the Act must be set forth in a separate document accompanying, but not included within, the firm's response letter.

Note: A firm may identify information in its response as confidential and may supply any supporting authority or other justification for according confidential treatment to the information. Consistent with Section 104(f), the Board shall protect the information from disclosure only if it is reasonable to characterize the information as confidential.

(c) After receiving and reviewing any response letter pursuant to paragraph (b) of this rule, the Board shall issue a final written inspection report. Prior to issuance of the final inspection report, the Board may take such action with respect to the draft inspection report as it considers appropriate, including adopting the draft report as the final report, revising the draft report, or continuing or supplementing the inspection before issuing a final report. In the event that, prior to issuing a final report, the Board directs the staff to continue or supplement the inspection or revise the draft report, the Board may, in its discretion, afford the firm the opportunity to review any revised draft inspection report.

Rule 4008. Transmittal of Final Inspection Report.

Promptly following the Board's issuance of a final inspection report, the Board shall transmit a copy of such final report –

(a) to the firm that is the subject of the report;

(b) to the Commission; and

(c) in appropriate detail, to each state, agency, board, or other authority that has issued a license or certification number authorizing the firm to engage in the business of auditing or accounting.

In the case of reports transmitted pursuant to paragraphs (b) and (c) of this rule, the report may be accompanied by any additional letter or comments by the Board or the

Board's inspector that the Board deems appropriate. In the case of reports transmitted pursuant to (c), the Board may omit from the report any information the disclosure of which could interfere with any investigation, prosecution, or disciplinary proceeding.

Rule 4009. Firm Response to Quality Control Defects.

(a) Following the receipt of any final inspection report that contains criticisms of, or potential defects in, the quality control systems of the firm under inspection, the firm may submit to the Director of the Division of Registration and Inspections evidence that it has improved such systems, and remedied such defects no later than 12 months after the issuance of the Board's final inspection report. After reviewing such evidence, the Director shall advise the firm whether he or she will recommend to the Board that the Board determine that the firm has satisfactorily addressed the criticisms or defects in the quality control system of the firm identified in the final inspection report and, if not, why not.

(b) After the Board makes its final determination, the Board shall notify the firm of its final determination concerning whether the firm has addressed the criticisms or defects in the quality control system of the firm identified in the final inspection report to the satisfaction of the Board.

(c) The portions of the Board's inspection report that deal with criticisms of or potential defects in quality control systems that the firm has not addressed to the satisfaction of the Board shall be made public by the Board –

(1) upon the expiration of the 12-month period described in paragraph (a) of this rule if the firm fails to make any submission pursuant to paragraph (a); or

(2) upon the expiration of the period in which the firm may seek Commission review of any board determination made under paragraph (b) of this rule, if the firm does not seek Commission review of the Board determination; or

(3) unless otherwise directed by Commission order or rule, 15 days after the firm formally requests Commission review pursuant to Section 104(h)(1)(B) of the Act.

Rule 4010. Board Public Reports.

Notwithstanding any provision of Rules 4007, 4008, and 4009, the Board may, at any time, publish such summaries, compilations, or other general reports concerning the procedures, findings, and results of its various inspections as the Board deems appropriate. Such reports may include discussion of criticisms of, or potential defects in, quality control systems of any firm or firms that were the subject of a Board inspection, provided that no such published report shall identify the firm or firms to which such criticisms relate, or at which such defects were found, unless that information has previously been made public in accordance with Rule 4009, by the firm or firms involved, or by other lawful means.

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Appendix 2 – Section-by-Section Analysis of Proposed Inspection Rules

There are 10 inspection rules (PCAOB Rules 4000 through 4010, with Rule 4005 reserved) plus a related definition (PCAOB Rule 1001(p)(iv)). Each of the rules is discussed below.

Proposed Inspection Rules

Rule 1001 – Definitions of Terms Employed in Rules

Professional Standards

The definition of professional standards in Rule1001(p)(iv) references that in Section 2(a)(10) of the Act. It should be noted that the term "professional standards" is broader than "auditing and related professional practice standards," which is defined in Rule 1001(a)(viii) of the Board's rules.

Rule 4000 – General

Consistent with Section 104(a) of the Act, Rule 4000 subjects every registered public accounting firm to all such regular and special inspections as the Board may from time-to-time conduct. The rule provides that inspection steps and procedures will be performed by the staff of the Division of Registration and Inspections and by such other persons authorized by the Board.

Rule 4001 – Regular Inspections

Rule 4001 requires that in performing a regular inspection, the staff of the Division of Registration and Inspections and other authorized persons take such steps

and perform such procedures as the Board determines are necessary or appropriate in order to assess the degree of compliance of each registered public accounting firm and associated persons of that firm with the Act, the Board's rules, the rules of the Commission, or professional standards, in connection with its performance of audits, issuance of audit reports, and related matters involving issuers. The rule requires the inclusion of steps and procedures set forth in Sections 104(d)(1) and (2) of the Act and such other tests of the audit, supervisory, and quality control procedures of the firms as the Director of the Division of Registration and Inspections or the Board determines.

Section 104(d)(1) requires the Board to "inspect and review engagements of the firm (which may include audit engagements that are the subject of ongoing litigation or other controversy between the firm and 1 or more third parties), performed at various offices and by various associated persons of the firm, as selected by the Board." Section 104(d)(2) requires the Board to "evaluate the sufficiency of the quality control system of the firm, and the manner of documentation and communication of that system by the firm."

Rule 4002 – Special Inspections

Rule 4002 requires that in performing a special inspection, the staff of the Division of Registration and Inspections and other authorized persons take such steps and perform such procedures, as are necessary or appropriate concerning the issue or issues specified by the Board in connection with its authorization of the special inspection. A note to the rule makes clear that under Section 104(b)(2) of the Act, the Board may authorize a special inspection on its own initiative or at the request of the Commission.

Rule 4003 – Frequency of Inspections

Rule 4003 sets forth the schedule for regular inspections. Rule 4003(a) is consistent with the schedule for larger registered public accounting firms set forth in Section 104(b)(1)(A) of the Act. This rule requires that beginning no later than the year after its registration with the Board has been approved, a registered public accounting firm that, during the prior calendar year, issued audit reports with respect to more than 100 issuers will be subject to a regular inspection. Rule 4003(b) is consistent with the schedule for smaller registered public accounting firms set forth in Section 104(b)(1)(B) of the Act. Rule 4003(b) requires that beginning with the three-year period following the calendar year in which its registration with the Board has been approved, a registered public accounting firm that, during any of the three prior calendar years, issued audit

reports with respect to at least one, but no more than 100, issuers, or that played a substantial role in the preparation or furnishing of an audit report with respect to at least one issuer, will be subject to a regular inspection.

In accordance with Section 104(b)(2), the Board is proposing Rule 4003(c) which adjusts the regular inspection schedule for a registered public accounting firm that has requested to withdraw from registration by filing a completed Form 1-WD.[1/] Specifically, the rule provides that the Board shall have discretion not to conduct a regular inspection that would otherwise commence during the period beginning on the fifth day following the filing of the completed Form 1-WD and continuing until the firm's registration is deemed withdrawn or the firm withdraws its Form 1-WD.

Rule 4004 – Procedure Regarding Possible Violations

Consistent with Section 104(c) of the Act, Rule 4004 sets forth procedures which the Board is required to follow with respect to possible violations by firms under inspection. Specifically, the rule requires that if the Board determines that information obtained by the Board's staff during any inspection indicates that the registered public accounting firm subject to such inspection, any associated person thereof, or any other person, may have engaged, or may be engaged in any act, practice, or omission to act that is or may be in violation of the Act, the rules of the Board, any statute or rule

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[1/] See PCAOB Release No. 2003-014 (July 28, 2003).

administered by the Commission, the firm's own quality control policies, or any professional standard, then the Board shall, if it determines it appropriate, report such possible violations to the Commission and each state or other authority that has issued a license or certification number authorizing such person or firm to engage in the business of auditing or accounting. Reporting to the Commission and other relevant authorities will be subject to Section 105(b)(5)(B) of the Act, which preserves the privileged and confidential nature of information that is referred by the Board.

In addition, under Rule 4004, if the Board determines it appropriate, the Board shall commence an investigation of such act, practice, or omission in accordance with Section 105(b) of the Act and the Board's rules thereunder or commence a disciplinary proceeding in accordance with Section 105(c) of the Act and the Board's rules thereunder.

The phrase "if it determines appropriate" in Rule 4004 means that the Board will decide which of these acts, practices and omissions would be appropriate to refer to the Commission and to the states or other authorities. In making this determination, depending on the nature of the possible violation, the Board could conclude that it may be appropriate to refer something to the Commission, and not the states or other authorities, and vice versa. A note to the rules makes clear that the Board may, as appropriate, make referrals other than those specifically described in Rule 4004.

Rule 4005 – Record Retention and Availability

Section 104(e) of the Act provides that the "rules of the Board may require the retention by registered public accounting firms for inspection purposes of records whose retention is not otherwise required by Section 103 or the rules issued thereunder." The Board is reserving this rule in anticipation of issuing standards on record retention as part of its standard setting process once it has experience with its inspection program. Registered public accounting firms should continue to comply with other applicable federal, state and professional record retention requirements.

Rule 4006 – Duty to Cooperate with Inspectors

Rule 4006 requires every registered public accounting firm and every associated person of such firm to cooperate with the Board in any Board inspection. The rule requires that such firms and persons must, among other things, provide access to, and the ability to copy certain records and provide such other relevant or material information as may be requested by the Board's inspectors.

Rule 4007 – Procedures for Firm Review of and Response to Draft Inspection Report and Issuance of Final Inspection Report

Rule 4007(a) requires the Director of the Division of Registration and Inspection to submit to the Board a written draft inspection report. Rule 4007(b) also requires that the Director to transmit the draft report to the firm under review, unless the Board directs

that transmittal be deferred. This paragraph of the rule permits the firm, within 30 days following transmittal of the draft inspection report, to submit to the Board by letter any comments, objections, recommended revision, or other views concerning the draft report. The rule requires that any portion of the firm's response that the firm believes is confidential be set forth in a separate document accompanying, but not included within, the firm's response letter.

A note to Rule 4007(b) points out that a firm that identifies any information in its response as confidential may supply any authority or justification for according confidential treatment to the information, but that the Board will not protect such information from disclosure unless it is reasonable to characterize the information as confidential. The Board anticipates that a substantial portion, if not all, of a firm's response will be directed to the portions of the report that deal with criticisms and potential defects in the firm's quality controls. For as long as the Board is required to keep those portions of the report confidential (12 months if the criticisms and potential defects are not satisfactorily addressed, indefinitely if they are addressed), the Board would, without the firm needing to make a specific request, maintain the confidentiality of the portions of the firm's response that address those matters. To the extent that a firm's response includes other matters, the Board will grant the firm's confidentiality

request to the extent that the Board determines that it is reasonable to treat the information as confidential.

Rule 4007(c) requires the Board to issue a final written inspection report after receiving and reviewing any response letter submitted by the firm pursuant to paragraph (b) of the rule. Prior to the issuance of the final inspection report, however, the rule permits the Board to take such action with respect to the draft report as it considers appropriate. For example, it may adopt the draft report as the final report, revise the draft report, or continue or supplement the inspection before issuing a final report. If the Board directs the staff to continue or supplement the inspection or revise the draft report, the Board may, in its discretion, afford the firm the opportunity to review any revised draft inspection report.

Rule 4008 – Transmittal of Final Inspection Report

Consistent with Section 104(g)(1) of the Act, Rule 4008(a) requires the Board to transmit a copy of the final inspection report to the firm that is the subject of the report, to the Commission, and in appropriate detail to each state, agency, board or other authority that has issued a license or certification number authorizing the firm to engage in the business of auditing or accounting. The rule makes clear that in the case of reports transmitted to the Commission or other relevant authority, the report may be accompanied by an additional letter or comments by the Board or its inspector. Also, in

the case of reports transmitted to a licensing or certification authority, the rule permits the Board to omit from the report any information the disclosure of which could interfere with any investigation, prosecution or disciplinary proceeding.

Rule 4009 – Firm Response to Quality Control Defects

Consistent with Section 104(g)(2) of the Act, Rule 4009(a) permits a firm that has received a report that contains any discussion of criticisms of, or potential defects in, the firm's quality control systems to submit to the Director of the Division of Registration and Inspections evidence that it has improved such quality control systems, and remedied such defects. This submission must be made no later than 12 months after the issuance of the Board's final inspection report. The rule requires the Director, after reviewing the evidence, to advise the firm whether he or she will recommend to the Board that the firm has satisfactorily addressed the criticisms or defects in the quality control system of the firm identified in the final inspection report and, if not, why not.

Rule 4009(b) requires the Board to notify the firm of its final determination as to whether the firm has addressed to the satisfaction of the Board the criticisms or defects in the firm's quality control system.

Rule 4009(c) provides that the Board will make public those portions of a final inspection report dealing with such criticisms and defects if the firm fails to address those matters to the Board's satisfaction within 12 months of the issuance of the final

inspection report. Rule 4009(c) specifically addresses the time of any such public disclosure. Under Rule 4009(c), if a firm made no submission to the Board under Rule 4009(a) concerning the firm's efforts to address the criticisms or potential defects, then the Board would make those portions of the report public upon the expiration of the 12-month period. If the firm made a submission under Rule 4009(a), but then failed to seek Commission review of an adverse Board determination concerning that submission within the time allowed to seek such review, the Board would make those portions of the report public upon the expiration of the period allowed for seeking Commission review. If the firm did timely seek Commission review, under Section 104(h)(1)(B) of the Act, of an adverse Board determination, the Board would make those portions of the report public 15 days after the firm formally requested Commission review, unless the Commission, by rule or order, directs otherwise. The Board is proposing the 15-day delay, subject to any superseding Commission rule or order, to allow the Commission an opportunity to consider whether to order a longer stay of public disclosure in a particular case, since the Act does not operate to stay such disclosure.

Rule 4010 – Board Public Reports

Rule 4010 permits the Board, at any time, to publish public summaries, compilations, or other general reports concerning the procedures, findings, and results of its various inspections as the Board deems appropriate. The rule allows for these

reports to include discussion of criticisms of, or potential defects in, quality control systems of any firm or firms that were the subject of a Board inspection. However, the rule prohibits these published reports from identifying the firm or firms to which these criticisms relate, or at which the defects were found, unless the information has previously been made public pursuant to the Board's rules or other lawful means.

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Exhibit 2(a)(2)

Tab Number	Comment Source
1	American Bar Association Committees on Law & Accounting and Federal Regulation of Securities of the Section of Business Law, *Authors: Thomas L. Riesenberg, Chair, Committee on Law & Accounting; and Dixie L. Johnson, Chair, Committee on Federal Regulation of Securities*, August 21, 2003
2	SEC Practice Section ("SECPS") of the American Institute of Certified Public Accountants, *Author: Robert J. Kueppers, Chair, SECPS Executive Committee*, August 18, 2003
3	SEC Practice Section ("SECPS") of the American Institute of Certified Public Accountants, *Author: Robert J. Kueppers, Chair, SECPS Executive Committee*, August 20, 2003
4	BDO Seidman, LLP, August 18, 2003
5	Deloitte & Touche LLP, August 18, 2003
6	Deloitte & Touche LLP, August 19, 2003
7	Ernst & Young LLP, August 18, 2003
8	Financial Services Agency, Government of Japan, *Author: Naohiko MATSUO, Director for International Financial Markets*, August 15, 2003
9	The Institut der Wirtschaftsprüfer (German Institute of Public Auditors) *Author: Klaus-Peter Naumann, Chief Executive Officer*, August 18, 2003
10	Institute of Chartered Accountants in England & Wales, *Author: David Illingworth, President*, August 18, 2003
11	The Japanese Institute of Certified Public Accountants, *Author: Akio Okuyama, President & CEO*, August 18, 2003
12	KPMG LLP, August 18, 2003
13	Most Horowitz & Company, LLP, *Author: Robert J. Sonnelitter, Jr., CPA*, August 7, 2003
14	National Association of State Boards of Accountancy, *Authors: David A. Costello, CPA President & CEO and K. Michael Conaway, CPA Chair, NASBA*, August 18, 2003
15	PricewaterhouseCoopers LLP, August 18, 2003
16	The Swiss Institute of Certified Accountants and Tax Consultants, *Authors: Andreas Müller, Chairman, Walter Hess, General Secretary*, August 18, 2003
17	U.S. General Accounting Office, *Author: David M. Walker, Comptroller General of the United States*, September 3, 2003

AMERICAN BAR ASSOCIATION
Section of Business Law
750 North Lake Shore Drive
Chicago, IL 60611

August 21, 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.006

Members and Staff of the Public Company Accounting Oversight Board:

This letter is submitted on behalf of the Committees on Law and Accounting and Federal Regulation of Securities of the American Bar Association's Section of Business Law (the "Committees") in response to the request by the Public Company Accounting Oversight Board (the "Board") for written comments on its proposed rules on inspections of registered public accounting firms (the "Proposal"). The Board issued the Proposal in response to §104 of the Sarbanes-Oxley Act of 2002 (the "Act"), which directs the Board to conduct a continuing program of inspections to assess the degree of compliance of each public accounting firm registered with the Board, and that firm's associated persons, with the Act, the rules of the Board, the rules of the Securities and Exchange Commission (the "Commission"), and professional standards in connection with the performance of audits, the issuance of audit reports, and related matters involving U.S. public companies.

The comments expressed in this letter represent the views of the Committees only and have not been approved by the American Bar Association's House of Delegates or Board of Governors and therefore do not represent the official position of the Association. In addition, this letter does not represent the official position of the ABA Section of Business Law, nor does it necessarily reflect the views of all members of the Committees.

Various members of our Committees represent public accounting firms, and some members represented clients in connection with the legislative activity that led to the Act. In preparing this comment letter, we have directed our comments to issues on which we have professional expertise.

I. General Comments

Section 104 of the Act directs the Board to conduct a continuing program of inspections to assess the degree of compliance of each registered public accounting firm and associated persons of that firm with the Act, the rules of the Board, the rules of the Commission, and professional standards in connection with the performance of audits, the issuance of audit reports, and related matters involving U.S. public companies. Within this framework, the Board has considerable discretion in establishing the procedures and requirements for the inspection program.

The Committees support the establishment of an inspection program and believe that the Board's inspection program should be designed to ensure that registered public accounting firms that audit SEC-registered issuers are in compliance with all applicable U.S. laws and professional standards. At the same time, the Committees believe that the Board should provide additional guidance on certain aspects of the Proposal to minimize potential confusion regarding certain aspects of the new inspection program.

We set forth below our comments with respect to specific aspects of the Board's proposed inspection program.

II. Specific Observations

A. Proposed Rule 4000: General

Under proposed Rule 4000, the Board apparently could authorize persons other than the staff of the Board's Division of Registration and Inspections to perform inspections on behalf of the Board.

While the Committees believe that it may be appropriate and necessary for the Board to engage "other persons" to undertake inspections in certain situations, the standards for engaging such persons under the proposed rule is quite open-ended. For example, Proposed Rule 4000 is silent with respect to whether the Board has established adequate procedures to ensure that any such "other persons" engaged by the Board would not disclose confidential and proprietary information about a firm made known to such individuals during an inspection. Insofar as the consequences to an inspected firm could be quite significant if sensitive information were to be inadvertently or deliberately disclosed by such other persons, the Committees recommend that the rules expressly establish (1) who may qualify to be an "other person" authorized to perform inspections on behalf of the Board, (2) the circumstances in which the Board may engage such "other persons," and (3) what steps the Board would take to ensure that such persons would be subject to appropriate oversight and supervision by the Board.

B. Proposed Rule 4002: Special Inspections

The Proposal authorizes the Board to perform both "regular" and "special" inspections. Under proposed Rule 4002, "special inspections" would be performed "as are

necessary and appropriate concerning an issue or issues specified by the Board in connection with its authorization of the special inspection." The Committees believe that the concept of a "special inspection" requires clarification, because it may prove difficult to distinguish between a "special inspection" under this Proposal and an "informal inquiry" under the Board's separate proposals relating to investigations and adjudications (PCAOB Rulemaking Docket Matter No. 005).

As we understand the Board's proposal, the purpose of an inspection – whether regular or special – is to assess firm-wide or systemic quality controls or compliance with applicable laws and professional standards. The Proposal should clarify that the purpose of an inspection is not to conduct an informal inquiry on behalf of the Board's Division of Enforcement and Investigation, as we believe that this would blur the distinctions between the responsibilities of the Division of Registration and Inspections and the Division of Enforcement and Investigation. Moreover, such "mission creep" would create a risk that some of the procedural protections afforded for registered public accounting firms and their associated persons under the Board's separate rules on investigations and adjudications will not be available. Consistent with that goal, we also recommend that the Board's staff provide notice if there is an informal or formal investigation underway at the time of an examination. In our experience, this is the typical practice followed by the SEC's Office of Compliance Inspections and Examinations ("OCIE").

Accordingly, while the Committees believe that the concept of a special inspection is appropriate, and that the various divisions of the Board should coordinate their activities to avoid duplicative work, we urge the Board to provide additional guidance on the purpose and scope of a special inspection.

C. Proposed Rule 4004: Procedure Regarding Possible Violations

Section 104(c)(2) of the Act states that the Board may make referrals of information relating to potential violations uncovered during an inspection to the Commission and to "each appropriate State regulatory authority." Proposed Rule 4004, however, suggests that Section 104(c)(2) does not limit the Board's authority to refer such information to other authorities not mentioned in the statute.

It appears to the Committees that Section 104(c) does limit the bodies to which information developed during an inspection could be referred, so it is unclear why the Board has concluded that such broader referrals are permissible under the Act. The Committees are concerned that extending referrals under §104 of the Act to other entities (for example, those identified under Section 105(b)(5)(B) of the Act) would blur the distinction between Board inspections and investigations. Accordingly, we recommend that the proposed Rule 4004 expressly limit referrals of information relating to potential violations uncovered during an inspection to the Commission and to each appropriate state regulatory authorities as set forth under §104(c).

D. Proposed Rule 4006: Duty to Cooperate With Inspectors

Under proposed Rule 4006, every registered public accounting firm, and every associated person of a registered accounting firm, must provide "access to, and the ability to copy, any record in the possession, custody, or control of such firm or person and providing, by oral interview, written response, or otherwise, such other information as may be requested by the Board's inspectors and that the Board considers relevant or material to the subject matter of the inspection."

While the Committees recognize that the duty to cooperate with inspectors is critical to the Board's inspection program, the proposed language that the Board may request "*any* record in the possession, custody, or control" of a registered public accounting firm or any every associated person "that the Board considers relevant or material to the subject matter of the inspection" is an overly broad and subjective standard. Accordingly, we urge the Board to clarify, consistent with the standard established under Section 104(a) of the Act, that materials "relevant or material" to the subject matter of an inspection would, by definition, specifically relate to a registered public accounting firm's compliance with the Act, Board or SEC rules, or applicable professional standards relating to the firm's performance of audits, issuance of audit reports, or related matters involving issuers.

E. Proposed Rule 4007: Procedures for Firm Review and Response to Draft Inspection Report and Issuance of Final Inspection Report

While Proposed Rule 4007 contemplates that a registered public accounting firm may review and comment on a draft inspection report before the Board issues a final written inspection report, it does specifically provide for or require an exit interview following an inspection (special or regular) and prior to the issuance of a draft report. In our experience, the SEC's OCIE generally provides for such interviews following examinations of registered broker-dealers and investment advisers.

F. Proposed Rule 4008: Transmittal of Final Inspection Report

Under Proposed Rule 4008, the Board must transmit a copy of a final inspection report to the Commission, the various state regulatory authorities, and the accounting firm that is the subject of the report. The proposal further contemplates that the inspection report, when sent to the Commission or a state regulatory authority, may be accompanied by "any additional letter or comments by the Board or the Board's inspector that the Board deems appropriate." While Section 104(g) allows the Board to provide inspection reports to such authorities accompanied by transmittal letters, the proposal, as drafted, is troubling. In particular, it raises the concern that the Board might routinely send detailed "side letters" to the Commission or state regulatory authorities at the end of an inspection relaying observations or other information that was not shared with the inspected firm. Conceivably, under the proposal, the Board could determine that an inspected firm had a systemic or firm-wide problem and notify the Commission and state regulators of the issue without ever having brought it to the attention of the firm or solicited its views or ability to adopt appropriate remedial measures.

In our view, this prospect would be inconsistent with the intent of Section 104(f) of the Act, as well as Proposed Rule 4007, each of which contemplates that a registered public

accounting firm should have an opportunity to review and respond to the Board's proposed inspection findings. While the Committees support the Board's authority to provide relevant information to appropriate regulatory authorities, we urge the Board to share any additional letter or comments with the inspected firm, as well as to provide such firm with the opportunity to respond to the findings in such additional letter or comments. In our view, transparency and openness between the Board and the accounting firms throughout the inspection process will best achieve the goals contemplated by Congress under the Act.

G. Issues Affecting Foreign Accounting Firms

Firms located outside the United States may face unique challenges in complying with the Board's inspection requirements, particularly where they conflict with obligations or restrictions imposed on the firms under the laws of foreign jurisdictions. The Board's proposal indicates that the Board is sensitive to such considerations and is committed to finding ways to accomplish the Act's goals without subjecting non-U.S. firms to "unnecessary burdens or conflicting requirements." In addition, the Board has announced that the nature and scope of the Board's oversight over non-U.S. accounting firms that audit the financial statements of U.S. public companies will be the subject of dialogue between the Board and its foreign counterparts. We support the Board's efforts to coordinate its activities with those of its counterparts outside the United States.

In this regard, we suggest that one issue merits clarification. The unique challenges that non-U.S. firms may confront under the Board's requirements could arise regardless of whether the non-U.S. firm was itself the subject of a Board inspection or was instead an "associated person" of another firm (for example, a U.S. firm) that was the principal subject of the inspection. Specifically, under Proposed Rule 4006, "[e]very registered public accounting firm, *and every associated person* of a registered public accounting firm, shall cooperate with the Board in the performance of any Board inspection" (emphasis added). Accordingly, the Board should make clear that it will be sensitive to the potential impact of its rules on non-U.S. firms in any context where a non-U.S. firm is asked to provide information in connection with a Board inspection that may subject the non-U.S. firm to duplicative oversight or conflicting legal obligations.

* * *

We appreciate the Board's consideration of the Committees' comments. Members of the Committees would be pleased to meet with representatives of the Board to discuss our comments.

Respectfully submitted,

/s/ Thomas L. Riesenberg

Thomas L. Riesenberg, Chair
Committee on Law & Accounting

/s/ Dixie L. Johnson

Dixie L. Johnson, Chair
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AICPA

SEC PRACTICE SECTION

August 18, 2003

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

Re: PCAOB Rulemaking Docket Matter No. 006

Members and Staff of the Public Company Accounting Oversight Board:

Due to the events over the past several days regarding the blackout in the Northeast which severely hindered most sources of communications (i.e., telephone and e-mail), the SEC Practice Section ("SECPS") of the American Institute of Certified Public Accountants is unable to provide written comments on the Public Company Accounting Oversight Board's ("PCAOB" or the "Board") proposed rules regarding inspections of public accounting firms by the 5 p.m. deadline.

However, the SECPS recognizes the proposed rules are important and we are serious about providing meaningful comments. Accordingly, the SECPS plans to submit our comments to the PCAOB by 5 p.m. on August 20. We hope that upon receipt of our letter, the Board will consider our comments as it deliberates final rules on this matter.

Thank you for your understanding and cooperation.

Sincerely,

Robert J. Kueppers
Chair
SECPS Executive Committee

August 20, 2003

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

Re: PCAOB Rulemaking Docket Matter No. 006

Members and Staff of the Public Company Accounting Oversight Board:

The SEC Practice Section ("SECPS" or the "Section") of 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 inspections of 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 business, industry, public practice, government and education. The AICPA bylaws require, among other things, that all members that engage in the practice of public accounting with a firm auditing one or more SEC clients as defined by AICPA Council are required to be members of the SECPS. There are approximately 1,100 firms that are members of the SECPS, which consists of approximately 750 firms that audit registrants that file financial statements with the U.S. Securities and Exchange Commission (the "Commission") and approximately 350 firms that have joined voluntarily. All of the Section's member firms are U.S. domiciled accounting firms. Neither the AICPA nor the SECPS has the jurisdictional authority to require firms domiciled outside the U.S. to join as members.

With the enactment of the Sarbanes-Oxley Act of 2002 (the "Act"), SECPS member firms that audit issuers and are registered with the Board will be subject to regular and special inspections as the Board may from time-to-time conduct. The SECPS seeks to assist its member firms in fulfilling its responsibilities required under the Act. To that extent, the SECPS appreciates the opportunity to comment on the Board's proposed rules on inspections of registered public accounting firms.

The SECPS supports the PCAOB in its efforts to fulfill its responsibilities of performing inspections of registered accounting firms as required by the Act. However, the Section believes the proposed rules could be clarified and improved in several respects. Most importantly, the proposed rules do not provide any clarity or guidance to registered public

accounting firms about the content of the inspection plans so that firms are aware of the criteria against which they are being measured. To further complicate the process, the proposed rules do not provide any clarity about the roles and responsibilities of the various parties involved in the inspection process.

In consideration of the Section's overall observations, the Section offers the following specific comments on the proposed rules:

Rule 4000 – General

The proposed rule provides that inspection steps and procedures will be performed by the Division of Registration and Inspections staff, "and by such other persons as the Board may authorize to participate in particular inspections or categories of inspections." While not expressly stated in the proposed rule, we assume that any "such other person" would be required to adhere to PCAOB Release No. 2003-008, *Ethics Code for Board Members, Staff and Designated Contractors and Consultants* ("Ethics Code"). Accordingly, the Section recommends that the proposed rule make reference to adherence to the Ethics Code by any "such other persons." Further, the Section recommends that the Board provide guidelines as to those circumstances under which any "such other person" would be participating. The Section assumes that any "such other person" would only be participating to assist the Board in fulfilling its inspection responsibilities.

Rule 4002 – Special Inspections

The note to the proposed rule states "the Board may authorize a special inspection on its own or at request of the Commission." First, we recommend that the Board provide due notice to firms once special inspections have been authorized. Second, we recommend that the Board clarify what is meant by the phrase "the Board may authorize" as it is unclear whether one Board member, a majority, or the full Board is necessary for authorization. The Section assumes that a majority vote is required by the Board, and recommends that the language in the proposed rule be clarified in this regard. Finally, we recommend that the Board provide greater specificity regarding the circumstances surrounding the commencement of special inspections.

Rule 4003 – Frequency of Inspections

The proposed rule states that a regular inspection will be performed at least once in every three calendar years for firms that issued an audit report with respect to one, but no more than 100 issuers, or that played a substantial role in the preparation or furnishing of an audit report with respect to at least one issuer. For firms that audit more than 100 issuers, the Board will perform a regular inspection on an annual basis. With the exception of firms that audit more than 100 issuers, the frequency of such inspections will be similar to the SECPS membership requirement as it relates to peer review. The Section has required that its member firms submit to peer review of its accounting and auditing practice every three years. In addition to the Section, approximately 35 States require peer review for licensure. The Section plans to continue its peer review program since many States require peer review of firms' entire

accounting and auditing practices, and the PCAOB inspections will only cover firms' SEC or issuer practices. However, the Section's peer review program will primarily focus on firms' non-SEC practice, as the PCAOB will be performing inspections or reviews of firms' SEC or issuer practices.

Since firms that are registered with the PCAOB will need both a PCAOB inspection and an SECPS peer review of its non-SEC practice, the Section believes it is important that the SECPS peer review program can be coordinated with the efforts of the PCAOB. The Section recognizes the hardship for firms having to undergo two reviews in order to meet both federal and state requirements. Accordingly, we encourage the Board to retain firms' pre-existing peer review cycles, to the extent possible, to assist the Section in coordinating the SECPS peer reviews with the PCAOB inspection activities.

Rule 4004 – Procedure Regarding Possible Violations

The note to the proposed rule states "the Board may, as appropriate, make referrals other than those specifically described in Rule 4004." We recommend the Board establish guidelines for such other referrals, as the language is currently vague and could lend itself to severe consequences for firms and its associated persons for minor infractions. For instance, there is no discussion regarding the materiality of matters subject to referral or on what basis referrals will be made. Under the proposed rule, it appears that even possible violations will be referred. The Section recommends that the Board provide guidelines under which referrals will be made. Further, the Section assumes that referrals will only be made as they relate to audits of issuers, and not to all audits, since the Board was only given authority under the Act with respect to audits of issuers. Accordingly, the Section recommends that the proposed rule include language clarifying that referrals will only be made as they relate to audits of issuers.

Rule 4005 – Record Retention and Availability

The Board did not provide for record retention guidelines in its proposed rule. The Section-by-Section Analysis states "The Board is reserving this rule in anticipation of issuing standards on record retention as part of its standard setting process once it has experience with its inspection program." The Section recommends that the Board provide guidelines to ensure consistent application in record retention by registered firms, particularly relating to firms' internal inspection records (such as offices visited, engagements reviewed, review checklists, etc.). SECPS member firms have been required to adhere to AICPA Quality Control Standards, which state in part that "A firm should prepare appropriate documentation to demonstrate compliance with its policies and procedures…Documentation should be retained for a period of time sufficient to enable those performing monitoring procedures and a peer review to evaluate the extent of the firm's compliance with its quality control policies and procedures." The SECPS Peer Review Program Manual further states "At the conclusion of an inspection [firm internal inspection], only the inspection summary or report should be retained until the team captain on the firm's next peer or quality review has the opportunity to review that summary or report. Typically, all detailed working papers should not be retained

after that summary or report is prepared. However, the detailed working papers on an inspection may be retained for a longer period if the firm expects the peer reviewer or quality reviewer to consider the inspection program to reduce the scope of the peer review or quality review. (Typically, reviewers of smaller firms will give little or no consideration to inspection due to the scope requirements and cost/benefit considerations.)" Since retention of internal inspection reports varies depending on the nature and size of the firm, and since detailed working papers of the inspection are typically not retained once the inspection summary or report is prepared, the PCAOB should consider establishing guidelines in this area if the Board has an expectation that is different from prior practice.

Rule 4006 – Duty to Cooperate with Inspectors

The proposed rule requires registered firms and their associated persons to cooperate with the Board. Such cooperation "shall include, but is not limited to, providing access to, and the ability to copy, any record" of the firm as requested. As currently written, we believe the rule is extremely broad and could lead to disagreements between inspectors and firms. We recommend the Board formalize its policy on the information that the Board may request, and recommend that the Board insert "relevant or material" before "record." Further, the Board should consider privacy issues that demand particular care with respect to confidential treatment (such as tax returns, employment information, communications with legal counsel regarding pending or threatened litigation, etc.). We also recommend that any such copies received be subject to the same retention requirements that are applicable to registered firms, so that the Board does not maintain copies for a period longer than the firms.

Rule 4007 – Procedures for Firm Review of and Response to Draft Inspection Report and Issuance of Final Inspection Report

The proposed rule provides for the Director of the Division of Registration and Inspections, at the conclusion of each inspection, to submit to the Board a written draft report. The proposed rule does not discuss parameters on what is to be included in the report, including thresholds, materiality, etc. We believe it is imperative that the Board establish inspection and reporting standards to ensure consistency in performance and reporting on inspections.

The proposed rule also states that the "Board may, in its discretion, afford the firm the opportunity to review any revised draft inspection report" (underline added for emphasis). We strongly recommend that the Board explicitly provide firms with the opportunity to review and respond to all revised draft reports. Accordingly, we suggest that the phrase in the proposed rule be modified to state the "Board shall afford the firm the opportunity to review and respond to any revised inspection report."

Finally, the proposed rule does not address the time period from the conclusion of the inspection to the presentation of the draft inspection report to the Board. It is unclear if presentation to the Board is normally to occur on the next business day or at any time during the year. Since completion of the inspection report is critical to firms in meeting their state licensing requirements, as those reports will need to be provided to the states, we recommend

that the Board establish protocols with respect to the timing and completion of inspection reports.

Rule 4008 – Transmittal of Final Inspection Report

The proposed rule states that any report transmitted by the Board to the Commission and/or to each state, agency, board or other authority that has issued a license or certification number authorizing the firm to engage in the business of auditing or accounting "may be accompanied by any additional letter or comments by the Board or the Board's inspector that the Board deems appropriate." In the spirit of fairness, the Section believes that firms should be afforded the opportunity to review and comment on any additional letters or comments by the Board, similar to the review process that is afforded to firms with respect to draft inspection reports.

Rule 4009 – Firm Responses to Quality Control Defects

The proposed rule, as well as the Act, makes reference to "criticisms of, or potential defects in, the quality control systems of the firm under inspection." Since such matters are to be publicly reported if not corrected by firms under inspection, we believe it is of utmost importance that the Board define what is meant by this phrase. If not defined, there may be confusion in matters that are reported to the public. For instance, it may be difficult for the public to distinguish the difference between minor infractions and those that are significant. Accordingly, we strongly encourage the Board to define what is meant by the phrase "criticism of, or potential defects in, the quality control systems of the firm under inspection."

The proposed rule provides for the Director of the Division of Registration and Inspection to "advise the firm whether he or she will recommend to the Board that the Board determine that the firm has satisfactorily addressed the criticisms or defects in the quality control system of the firm identified in the final inspection report and, if not, why not." As currently drafted, firms are to provide evidence to the Director that previously identified quality control defects have been corrected, and the Director then makes a recommendation to the Board. After the Director receives such evidence from the firm, he or she could determine that such evidence is insufficient and makes such recommendation to the Board. However, if the firm was made aware of this fact, the firm should have an opportunity to provide additional evidence to the Director, which may lead to a very different outcome. As currently drafted, the proposed rule does not provide firms with the ability to provide additional information to the Director. Accordingly, we recommend that firms be provided with ample and sufficient opportunity to provide any additional information or clarification to the Director prior to the Director's recommendation to the Board.

The proposed rule contains a provision that no criticisms of, or potential defects in, the quality control system of a firm under inspection will be made available to the public, unless the firm failed to correct such criticisms or defects within 12 months after the date of the inspection report. Because of the importance of such confidentiality provision, which was recognized in the Act, the Section recommends that the proposed rule further clarify that firms should

likewise be required to withhold the report for 12 months. The Section has a concern that despite the confidentiality that is afforded in the Act, external parties may try to seek such information by obtaining it from the firm and circumvent the remedial aspects of the process set forth in the Act. The Section strongly encourages the Board to mandate that firms keep such reports confidential until the reports are made publicly available by the Board.

The proposed rule provides that a firm has "12 months after the issuance of the Board's final inspection report" to remedy any criticisms of, or potential defects in, the quality control systems of the firm. It is unclear what is meant by "issuance" of the Board's final inspection report. Is this the date the report is issued or the "as of" date of the report? There could easily be a six-month or longer difference, thus possibly giving a firm just a short window to correct deficiencies that existed "as of" the inspection date. For instance, if the PCAOB inspects a firm as of March 31, takes several months to perform the inspection, and issues the report on September 30, does the firm have 12 months from September 30 or from March 31 to correct matters? The Section assumes that it would be the September 30 date; however, given the importance of this matter, the Section strongly encourages the Board to clarify the timing to avoid any confusion and to ensure firms are provided with a full 12 month period to correct any matters noted from the Board's inspection activities.

Further, the reporting portion of the proposal does not describe how many reports a firm may receive as a result of the Board's inspection activities. The Section assumes that the Board will issue a single report upon completion of a regular inspection. Use of multiple reports on a single firm's inspection could create misunderstanding and render it more difficult to coordinate with the Section's peer review activities with respect to the audits of non-issuers.

Finally, the proposed rule does not address the period the firm's inspection report will remain in the public records. The Section recommends that only the current report remain in the public records since it is the only report of significance as it is most representative of the firm's current ability or "fitness" to perform audits of issuers.

Rule 4010 – Board Public Reports

The proposed rule provides that "the Board may, at any time, publish such summaries, compilations, or other general reports concerning the procedures, findings, and results of its various inspections as the Board deems appropriate." The proposed rule further states "no such published report shall identify the firm or firms." The Section agrees that the Board should not identify the firm or firms, and encourages the Board to be cautious in its publication of such reports so that the firm or firms could not be inferred. For instance, the Board should not make reference to a firm's location and/or size of practice, as this information may cause a reader to infer the identity of the firm.

CONCLUSION

We acknowledge the enormous effort put forth by the members and staff of the PCAOB to implement the provisions of the Act. Inspections of registered public accounting firms are critical to the Board's mission to oversee the audits of public companies. We appreciate the opportunity to provide comments concerning the Board's proposed rules on inspections of registered public accounting firms. We are firmly committed to working with the PCAOB in accomplishing the timely and effective implementation of the Act, including that of inspections, and would welcome the opportunity to meet with you to clarify any of our recommendations.

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Sincerely,

Robert J. Kueppers
Chair
SEC Practice Section Executive Committee

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August 18, 2003

Via E-mail

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. 006

Members and Staff of the Public Company Accounting Oversight Board:

We are pleased to provide our comments regarding the Board's proposed rules on inspections. Generally, we believe the proposal reasonably reflects the provisions of the Sarbanes-Oxley Act of 2002 ("the Act"). However, there are various provisions of the proposed rules that we believe should be modified to provide clarification and otherwise enhance the effectiveness and efficiency of the inspection process, while continuing to protect the public interest. Our comments are as follows:

Inspection Approach

Proposed Rule 4001 requires reviews of engagements performed at various offices of a registered firm. This approach appears to be similar to the current peer review model. In that regard, we suggest that the Board consider utilizing the guidelines for engagement selection, scope, and risk-based questionnaires used in the current AICPA SEC Practice Section peer review process. These guidelines and tools have been developed over many years with significant practical benefits and have been accepted by the staffs of the Public Oversight Board and SEC. We believe use of this material would enhance the rapid implementation of the inspection program within a framework that would meet the public interest and is one that is most familiar to those involved in the process. Of course, we would expect the Board to tailor such material to reflect current concerns and risks, with subsequent modification reflecting new professional standards and changes in the environment.

We also suggest use of an approach for those firms subject to annual inspection that would entail (1) in the first year after the firm is registered, reviews of the design of its quality control policies and procedures and a sample of audit workpapers and (2) in each of the next two years (a) review of changes in the firm's quality control policies and procedures, including ensuring that appropriate changes were made to comply with new professional standards and (b) on-site "piggyback" reviews of the firm's internal inspection program. This cycle would repeat itself in the fourth year. We believe such an approach would ensure continuous monitoring of registered firms on an annual basis, while making the best use of the resources available to the Board.

We also recommend that the inspection practices attempt to maximize the continuity of reviewers assigned to a particular firm. For larger firms requiring annual inspections, substantial time is needed to become sufficiently familiar with the firm's audit policies and procedures and the nature of its public company clients to perform an effective review. Once that level of knowledge is obtained, it should be preserved to the fullest extent possible.

Finally, we strongly urge the Board to have inspections conducted outside of the traditional time of the year that the firm conducts the majority of its audits. This would enable firms to complete the audits within the accelerated deadlines recently enacted, maximize the availability of non-staff reviewers (see below), and avoid the disruptions that would otherwise result.

Inspection Resources

Proposed Rule 4000 provides for the Board to authorize non-staff persons to participate in inspections. In that regard, we recommend that such potential resources include current partners and managerial employees of public accounting firms, acting either through review teams representing such firms or through suitably qualified individuals from various firms coming together to form a coordinated group. In either case, these reviews should be closely directed by representatives of the Board's staff. This structure would ensure that appropriate and sufficient technical resources (including industry expertise) are brought to bear on the significant inspection effort, while ensuring the public interest is protected by requiring the direct involvement of the Board's staff in managing the inspection, including final decision-making regarding key issues that arise during the process.

We would be pleased to provide appropriate technical resources to assist the Board with inspections.

Integration with Peer Reviews of the Non-issuer Portion of a Firm's Audit Practice

As the Board is aware, various states require a triennial peer review of a firm's audit practice in order to maintain its licensing credentials. It does not appear that limiting these reviews to a firm's SEC practice would fulfill the peer review requirements of the states. Accordingly, since we understand that the Board's inspection program is intended to focus only on audits of issuers, a firm will need to ensure that the non-issuer portion of its practice is subjected to an external peer review under an acceptable program. We urge the Board to work with the accounting profession and the National Association of State Boards of Accountancy in establishing a coordinated inspection program under which the Board's inspection of issuers and the external peer review of non-issuers can be integrated with a

minimum of redundant effort, thereby reducing the substantial out-of-pocket costs and diversion of technical resources that would otherwise occur.

Correction of Quality Control Defects

We agree with the proposal to provide firms 12 months to correct quality control defects or criticisms described in an inspection report. This acts as an incentive for firms to correct these matters on a timely basis, while still providing the Board with the ability to monitor how the firm implements its corrective actions, thereby protecting the public interest. However, we also believe that the Rule should recognize that some deficiencies may be so egregious that they may need to be corrected in a shorter time period.

In connection with the Board's procedures to review evidence of firm corrective action, we believe it is important for Rule 4009 to explicitly require communications between the Board and the firm during the 12-month period (rather than only after the firm formally submits its evidence), to enhance the ability of the firm to modify its corrective action to satisfy interim concerns of the Board. Otherwise, a firm could face the prospect of the Board's rejection of its corrective action and the consequent loss of reputation and potential inability to audit issuers. Similarly, we recommend that the rule require the Director to issue a draft report for review by the firm within a reasonably prompt prescribed time frame after submission of the firm's evidence of corrective action before making his or her recommendation to the Board.

Proposed Rule 4009 provides for public disclosure of criticisms 15 days after a firm formally requests Commission review unless the Commission directs otherwise. With all of the SEC's other responsibilities, it appears that 15 days is an unreasonably short period to expect it to review a final Board decision. We suggest that a longer period (e.g., 30 days) would be more realistic in the circumstances.

Violation of a Firm's Quality Control Policies

Proposed Rule 4004 and Section 104 of the Act seem to equate violations of a firm's own quality control policies with violations of the Act or professional standards. While violation of a firm's own quality control policies may be indicative of a weak quality control environment, which should be the subject of corrective action, we are concerned that elevating the implications of such violations may have the counterproductive effect of providing a disincentive for firms to adopt policies that exceed professional standards, but represent best practices. Accordingly, we strongly urge the Board to indicate explicitly in the Rule or Appendix 2 that it will exercise appropriate judgment when addressing a firm's violations of its own policies when it otherwise complies with professional standards.

While the proposed Rule implicitly provides that criticisms that the firm has addressed to the Board's satisfaction will not be made public, we believe this provision should be made explicitly. Moreover, since, under Proposed Rule 4008, final inspection reports and possibly an additional letter or comments are to be sent to certain states or other licensing authorities, such authorities should be notified by the Board if it ultimately determines that a firm has satisfactorily addressed the criticisms or defects. Otherwise, these authorities might be operating under the false assumption based on the report it originally received that there continue to be unresolved defects at the firm.

Review of Drafts

Proposed Rule 4007 provides that prior to issuing a final report reflecting a firm's response letter, the Board may, at its discretion, afford the firm the opportunity to review the draft. We believe it would always be appropriate to afford firms such opportunity. In addition, we recommend that the reference to the draft inspection report also include reference to any additional letter of comments.

We do not understand the circumstances under which the Board would direct that the transmission be deferred. This should be clarified.

Special Inspections

Item A2 of the Overview indicates that special inspections will be conducted as necessary to address issues that come to the Board's attention, including through informal means such as informants and news reports. We would expect that the nature and extent of such inspections would be reflective of the nature of the source of the information. Accordingly, we believe that sources such as anonymous tips or uncorroborated media stories ordinarily should initially precipitate informal questions of the firm, as opposed to a formal inspection. We suggest that such guidance be incorporated in the final Rule 4002.

* * *

A credible inspection process is a critical element of the Board's oversight role. We appreciate the efforts that have been and will be undertaken by the Board in translating the provisions of the Act into a practical approach to implementing a highly complex inspection process. In that regard, we stand ready to assist the Board, where appropriate. Moreover, we applaud the Board for its willingness to continue to dialogue with its foreign counterparts to achieve the goals of the Act without unnecessary burdens being placed on foreign firms.

We also appreciate this opportunity to express our views to the Board. We would be pleased to answer any questions the Board or its staff might have about our comments. In that regard, please contact Wayne Kolins at 212-885-8595 or via electronic mail at wkolins@bdo.com.

Very truly yours,

/s/ BDO Seidman, LLP

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Deloitte
& Touche

August 18, 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. 005 -- Proposed Rules on Investigations and Adjudications, and PCAOB Rulemaking Docket Matter No. 006 -- Proposed Rules on Inspections of Registered Public Accounting Firms

Deloitte & Touche LLP would like to inform the Office of the Secretary of its intention to submit comment letters on the above referenced proposed rules. Due to circumstances related to the widespread power outage in the northeast region which began this past Thursday, we have not been able to finalize our comment letters by today's deadline of 5:00 pm (EDT). These proposed rules are of significant importance to us, and we will be submitting our comment letters to the Board within the next one or two days.

Very truly yours,

/s/ Deloitte & Touche LLP

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Deloitte & Touche

August 19, 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. 006

Proposed Rules on Inspections of Registered Public Accounting Firms

Deloitte & Touche LLP is pleased to respond to the request for comments from the Public Company Accounting Oversight Board (the "PCAOB" or the "Board") on its *Proposed Rules on Inspections of Registered Public Accounting Firms*, PCAOB Rulemaking Docket Matter No. 006 (July 28, 2003).

INTRODUCTION

We support the goals of the Sarbanes-Oxley Act of 2002 (the "Act") in restoring investor confidence as well as the Board's efforts to implement the Act faithfully. The Act requires that the Board perform annual inspections of registered public accounting firms that regularly provide audit reports for more than 100 issuers, and triennial inspections of firms that regularly provide audit reports for 100 or fewer issuers. These inspections are designed for the Board to assess firms' compliance with the Act, the rules of the Board and the Securities and Exchange Commission ("SEC"), the firms' own quality control policies, and professional standards in

connection with the performance of audits, the issuance of audit reports and related matters involving issuers.[1]

In this comment letter, we have identified aspects of the Board's proposed rules that we believe should be clarified or modified in order both to facilitate the conduct of inspections and to enhance the ability of registered public accounting firms to understand and to respond appropriately to the requirements associated with inspections. We begin with a few general comments, which are followed by specific comments that track the order of the rules proposed in the Board's Release No. 2003-013, dated July 28, 2003 (the "Release").

I. GENERAL

We have several general concerns that we believe the Board should consider as it finalizes the proposed rules.

First, the Board's proposed rules contain little in the way of substantive guidance on the inspection process. The Release state that the Board's proposed rules on inspections "govern procedural matters concerning the Board's inspection program," but that Board staff will carry out particular inspections according to "detailed, nonpublic inspection plans."[2] The Board should provide guidance to registered public accounting firms about the conduct of inspections so that firms are better prepared to participate in the inspection process and are aware of and have appropriate insight about the substantive criteria by which they are being evaluated. It seems only reasonable that firms should have a clear understanding of the inspection process and the evaluative criteria to be used.

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[1] *See* Act, §§ 104(a) and 104(c)(1).

[2] Release at 2, n.2.

Second, as discussed in connection with a number of the specific comments set forth below, we believe that certain provisions of the Board's proposed rules are overly broad and unnecessarily vague. The proposed rules do not provide sufficient clarity and specificity regarding the duties, rights and responsibilities of the various parties involved in the inspection process. Nor do they provide the Board's staff or firms with sufficient direction and information regarding the overall inspection process, the conduct of inspections, or the form of the resulting inspection reports. In the remainder of this letter, we provide additional comments regarding particular areas of the proposed rules that require greater clarity and specificity. In the absence of clarification and additional detail, unfairness, inefficiencies and needless confusion could result, thereby compromising the effectiveness of the inspection process.

Third, the Release states that the proposed rules apply to inspections of registered public accounting firms.[3] The Board states in the Release that non-U.S. public accounting firms are not required to register with the Board until April 19, 2004, at which time they may become subject to the inspection rules.[4] The Board should clarify that, other than U.S. registered public accounting firms, non U.S. "associated persons" of either U.S. registered public accounting firms or non-U.S. public accounting firms that register on or before April 19, 2004 also will not be subject to the inspection rules until, at the earliest, April 19, 2004.

Finally, the proposed rules should explicitly state that the scope of the Board's inspections will not extend to non-issuer clients or to services that registered public accounting firms provide to non-issuers. This would be consistent with Section 104(a) of the Act, which

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[3] *Id.* at 9.

[4] *Id.* The Board also states in the Release that its proposed rules "are not intended in any way to signal that the Board has already determined how its oversight should operate as to [non-U.S.] firms, or to preclude any adjustments that may be appropriate" in light of the Board's discussions with its foreign counterparts. *Id.* at 9-10.

limits the Board's inspection authority to firms' "performance of audits, issuance of audit reports, *and related matters involving issuers*" (emphasis added). Although proposed Rule 4001 contains similar language, this rule governs only regular inspections. Accordingly, we believe a broader statement that the Board's inspection process does not cover firm activities pertaining to non-issuer clients would be appropriate.

II. DEFINITIONS—"PROFESSIONAL STANDARDS"

As an initial matter, the Board should either clarify that the use of the term "professional standards," as defined in proposed Rule 1001(p)(iv), is not intended to expand the scope of conduct for which accounting firms may be subject to investigation or discipline, or instead use the term "auditing and related professional practice standards" when referring to the responsibilities of auditors. Unlike the term "auditing and related professional practice standards," which is defined in Rule 1001(a)(viii) of the Rules of the Board to include auditing standards, related attestation standards, quality control standards, ethical standards, independence standards, and other professional standards established or adopted by the Board under Section 103 of the Act, the term "professional standards," as used in Section 2(a)(10) of the Act and proposed Rule 1001(p)(iv), will encompass accounting principles as well. The Board acknowledges in the "Section-by-Section Analysis" of the Release that "professional standards" are broader than "auditing and related professional practice standards," but this should not be understood to extend the Board's inspection, investigation, and disciplinary authority beyond the Board's mission to oversee the integrity of public company audits.[5]

The inclusion of accounting principles in the term "professional standards" is important because under proposed Rule 4004, the Board has authority to refer firms to the SEC and

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[5] *Id*. at A2-i.

relevant licensing and certification authorities, and to commence investigations or disciplinary proceedings, in connection with any act, practice or omission by a firm, any associated person of a firm, or any other person that may be in violation of any "professional standards." As proposed, it appears that the definition of "professional standards" could be read to expand the auditor's responsibility and subject accounting firms to discipline for departures by issuers of generally accepted accounting principles even when a firm has acted with due professional care.

We are concerned that any such expansion is inconsistent with an auditor's responsibility under generally accepted auditing standards. Primary responsibility for the application of accounting principles rests with management of an issuer. Auditors have a responsibility to perform an audit under generally accepted auditing standards and to report on the financial statements based upon the audit. The resulting audit report contains an opinion as to whether the financial statements are presented fairly and in conformity with generally accepted accounting principles with regard to all material matters. This opinion has always been understood to provide reasonable, but not absolute, assurance regarding the financial statements.[6]

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[6] *See* AU 110.02 – 110.03 (Responsibilities and Functions of the Independent Auditor), which states that:

> The auditor has a responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. Because of the nature of audit evidence and the characteristics of fraud, the auditor is able to obtain reasonable, but not absolute, assurance that material misstatements are detected. The auditor has no responsibility to plan and perform the audit to obtain reasonable assurance that misstatements, whether caused by errors or fraud, that are not material to the financial statements are detected.
>
> The financial statements are management's responsibility. The auditor's responsibility is to express an opinion on the financial statements. Management is responsible for adopting sound accounting policies and for establishing and maintaining internal control that will, among other things, initiate, record, process, and report transactions (as well as events and conditions) consistent with management's assertions embodied in the financial statements. The entity's transactions and the related assets, liabilities, and equity are within the direct knowledge and control of management. The auditor's knowledge of

Auditors should be responsible, as they traditionally have been, for conducting audits of issuers' financial statements in accordance with generally accepted *auditing* standards. The Board's proposed rule should not fundamentally expand the role and responsibility of the auditor. Accordingly, if the Board determines that there has been a misapplication of generally accepted accounting principles, before it concludes that an auditor has not met its responsibilities, there should be further consideration of whether, and a determination that, there has been a violation of auditing and professional practice standards before a matter is referred or a disciplinary proceeding is commenced.

III. PROPOSED RULE 4000 "OTHER PERSONS" AUTHORIZED TO PARTICIPATE IN INSPECTIONS

Proposed Rule 4000 states that "[i]nspection steps and procedures shall be performed by the staff of the Division of Registration and Inspections, and by *such other persons as the Board may authorize to participate in particular inspections or categories of inspections*" (emphasis added). The Board should provide specific guidance regarding who are the "other persons" who can be authorized to participate in inspections and should set out the circumstances under which their participation can be authorized. The proposed rule does not appear, for example, even to require that these "other persons" be members of the Board's staff.

In this regard, because they will have access to information that may be highly confidential, the Board should limit the instances in which persons other than Board staff can be authorized to participate in inspections. In addition, the "other persons" should be required to

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these matters and internal control is limited to that acquired through the audit. Thus, the fair presentation of financial statements in conformity with generally accepted accounting principles is an implicit and integral part of management's responsibility. The independent auditor may make suggestions about the form or content of the financial statements or draft them, in whole or in part, based on information from management during the performance of the audit. However, the auditor's responsibility for the financial statements he or she has audited is confined to the expression of his or her opinion on them.

satisfy some uniform criteria reasonably designed to ensure that they have appropriate professional qualifications and are free from conflicts of interest. To the extent that such "other persons" are called upon to exercise certain powers of the Board, additional restrictions may be appropriate or necessary. "Other persons" that participate in inspections should also be required to sign confidentiality agreements stipulating that they are bound by the same confidentiality obligations as are the Board and its staff.

IV. PROPOSED RULE 4001 REGULAR INSPECTIONS

Proposed Rule 4001 provides that the procedures that the Board performs in connection with regular inspections must include an inspection and review of "selected audit and review engagements" of firms, as set forth in Section 104(d)(1) of the Act. For purposes of clarification, the Board should revise proposed Rule 4001 to provide that "selected audit and review engagements" do not include engagements that are ongoing at the time an inspection is conducted. We believe that it would be inappropriate for the Board to examine engagements that are in process as part of an inspection because the examination necessarily would result in a distorted picture of these engagements and would otherwise be unduly disruptive to the completion of the audit.

V. PROPOSED RULE 4002 SPECIAL INSPECTIONS

Proposed Rule 4002 should provide greater specificity about the circumstances for the initiation of special inspections. Special inspections are those inspections conducted other than once each calendar year, or once every three calendar years, depending on the firm.[7]

First, the Board should clarify under what circumstances and by what procedures a special inspection will be initiated. The note to proposed Rule 4002 states that special

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[7] *See* Proposed Rules 4003(a) and 4003(b).

inspections can be initiated "on [the Board's] own initiative" or at the request of the SEC. This language could be interpreted to necessitate, and appropriately so, formal Board action, which, under Section 4.3 of the Board's Bylaws, requires a quorum and approval of a majority of the Board's members. Alternatively, it could be read to permit initiation of special inspections whenever some of the Board's members deem it necessary or appropriate, or upon approval of Board staff alone. Proposed Rule 4002 is silent as to when the SEC may request special inspections.

To ensure that special inspections are initiated only when circumstances warrant, formal Board action – that is, a quorum and approval of a majority of the Board's members – should be required in order to initiate a special inspection, including in instances where the SEC requests that the Board undertake a special inspection. Moreover, to remove any implication to the contrary, we believe that proposed Rule 4002 should be amended to clarify that the Board has the same authority in the context of a special inspection that it has in conducting regular inspections.

Second, proposed Rule 4002 does not explicitly provide for notification to a firm at the time a special inspection is initiated, which leaves open the possibility that the Board could undertake "surprise" inspections by sending staff to a firm's offices without prior notice, to review records or interview firm personnel. This creates an ambiguity when viewed in light of proposed Rule 4006, which requires firms and their associated persons to cooperate in inspections and clearly contemplates that firms will receive sufficient notification of an inspection to provide documentation and other information relevant to the inspection. We believe that the Board should notify firms of a special inspection immediately upon authorization of the inspection (and sufficiently in advance of its initiation) and that proposed Rule 4002 should be revised to provide for such notification.

Third, the Release states that an inspection can be commenced "based on information that comes to the attention of the Board or its staff in any way," including through SEC filings, news reports and "matters brought informally to the attention of the Board's staff by other regulators, professional associations, informants, and members of the public."[8] Neither the Release nor the proposed rule establishes a specific standard that would trigger special inspections. Presumably, mere rumors of a violation would not be sufficient grounds for the Board to commence a special inspection. In this regard, we believe it would be appropriate to establish a minimum threshold that must be satisfied before the Board can commence a special inspection, such as a reasonable belief on the part of a majority of the Board that a violation of the Act, the rules of the Board, any statute or rule administered by the SEC, the firm's own quality control policies, or any professional standard, may have occurred. Incorporating this standard into proposed Rule 4002 would leave the Board free to initiate inspections as special circumstances warrant.

VI. PROPOSED RULE 4004 PROCEDURE REGARDING POSSIBLE VIOLATIONS

Proposed Rule 4004 grants the Board sweeping authority to refer information to the SEC and relevant licensing and certification authorities, including authority to make additional referrals other than those specifically described in the rule. The Board should establish parameters governing when, and to whom, it may make additional referrals and these parameters should be reflected in proposed Rule 4004.

The Act and proposed Rule 4004 provide for referrals to the SEC and relevant licensing and certification authorities "if appropriate."[9] Similarly, the Board has discretion under the note to proposed Rule 4004 to make other referrals "as appropriate." This is a substantial grant of

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[8] Release at 7.

[9] *See* Act, § 104(c)(2); proposed Rule 4004(a) (the Board "shall" make a referral "if it determines appropriate").

discretion to the Board, particularly because the language of proposed Rule 4004 allows the Board to refer firms to the SEC and relevant licensing and certification authorities upon any "indication" that there "may be" or "may have been" a violation. If, however, the Board were to make a referral every time there is a suggestion of a potential violation, the referral system would be administratively unworkable for both the Board and other authorities that oversee registered public accounting firms. The Board would be forced to expend significant resources preparing referrals based on the scantest of evidence, and recipients of referrals would face the prospect of substantial additional follow-up to assess the merits of alleged violations referred by the Board. Meanwhile, the Board would continue to perform its own assessments of potential violations to determine whether to commence investigations and disciplinary proceedings, resulting in a substantial duplication of effort by the Board, the SEC, and state licensing and certification authorities.

Moreover, referring firms to the SEC and relevant licensing and certification authorities on the basis of mere indications of suspected potential violations could cause unwarranted damage to a firm's professional stature and would not be in the interest of the public or consistent with the Board's mission. Unfounded allegations of wrongdoing by a firm that may become public would unnecessarily undermine investor confidence in the integrity of the financial reporting process, and responding to such allegations would divert firms' resources from the performance of audits.

Accordingly, we believe that the Board should exercise the discretion afforded to it by the language of the Act to establish standards for determining the propriety of referrals. For example, as proposed, Rule 4004 would permit the Board to make referrals in cases where there may be a violation of generally accepted accounting principles. As discussed above, we believe a further determination regarding a deviation from generally accepted auditing standards should

be required prior to referring a matter to the SEC or relevant licensing and certification authorities or initiating a disciplinary proceeding. The need for such a limitation is particularly compelling because, as the proposed rule is currently drafted, even a single omission of a minor disclosure required under generally accepted accounting principles, that in the overall picture is not material to the financial statements and that may not bear any relationship to the firm's conduct of an audit under generally accepted auditing standards, or a departure from such standards, could trigger a referral or a disciplinary proceeding.

VII. PROPOSED RULE 4006 DUTY TO COOPERATE WITH INSPECTORS

As proposed, Rule 4006 would require that all registered public accounting firms and their associated persons cooperate with the Board in the performance of "any" Board inspection. Proposed Rule 4006 would require firms to provide the Board with access to, and the ability to copy, "any record" in their possession, and to give the Board access to "such other information as may be requested by the Board's inspectors and that the Board considers relevant or material to the subject matter of the inspection."

The vast expanse of information to which the Board would have access under proposed Rule 4006 raises serious concerns. As drafted, proposed Rule 4006 seemingly requires firms to provide the Board with access to and the ability to copy "any" record in their possession, even if the record has no relevance to an inspection. As an initial matter, therefore, the language of the proposed rule must be revised to confirm that the proposed rule's proviso regarding "relevan[ce] or material[ity] to the subject matter of the inspection" applies to records.

Even if records are relevant to an inspection, moreover, the Board should not have an unfettered ability to copy those records. Client confidentiality dictates that the duplication of records should be limited in order to avoid inadvertent disclosure of confidential information. Accordingly, before Board staff is permitted to duplicate and remove copies of records from the

offices of registered public accounting firms, we believe that the staff should be required to demonstrate a reasonable need for copies of the records that could not be met through mere access to those records.

Another difficulty raised by the expansive language of proposed Rule 4006 is that it contains no safeguards to ensure that firms or their associated persons can assert any common-law or constitutional privileges, such as the attorney-client privilege or the work product doctrine, once confronted with an actual request from the Board under the rule. Accordingly, the Board should confirm that firms and individuals may assert legally recognized protections in objecting to particular requests for documents, interviews and other information, and that the Board will not view the assertion of privileges as a failure to cooperate with the Board in the performance of an inspection.

In addition, providing client confidential information to a third party, including the Board, presents numerous potential conflicts with state laws and with non-U.S. laws and professional standards.[10] Therefore, we are concerned that proposed Rule 4006 would place firms and their associated persons in the untenable position of either refusing to comply with – and thereby possibly violating – the Board's rule on cooperating with inspectors, or providing client information to the Board, and thereby committing an act that may violate state law or non-U.S. laws or professional standards.

To avoid the harsh consequences to which proposed Rule 4006 could lead, we recommend that the Board amend the proposed rule to provide that the production of documents

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[10] *See* App. A to Comment Letter, dated March 31, 2003, on behalf of Deloitte & Touche LLP, the Non-U.S. Member Firms of Deloitte Touche Tohmatsu, and Deloitte Touche Tohmatsu on the PCAOB's Proposed Registration System for Public Accounting Firms, PCAOB Rulemaking Docket Matter No. 001 (outlining potential conflicts between the consent provision in Item 8.1 of the Board's proposed registration rules and confidentiality requirements in the laws and professional standards of certain foreign countries).

and other information covered by the rule is required only to the extent consistent with applicable laws and professional standards and to include an express reservation that firms and their associated persons would maintain their rights to assert any legally recognized grounds for objecting to a request for documents, interviews or other information. Specifically, the rule should provide that before firms or their associated persons are required to turn over information to the Board, they will have an opportunity to be heard with respect to any legal grounds they may have for not producing information to the Board.

VIII. PROPOSED RULE 4007 PROCEDURES FOR FIRM REVIEW OF AND RESPONSE TO DRAFT INSPECTION REPORT AND ISSUANCE OF FINAL INSPECTION REPORT

We have identified several changes to proposed Rule 4007 that we believe are integral to the fairness and accuracy of the inspection reporting process. As a general matter, the proposed rule does not outline any parameters regarding the preparation of inspection reports, including matters such as the content and format of reports and thresholds related to findings discussed in reports. The provisions of proposed Rule 4007(b) that address confidentiality are not sufficiently specific and require further clarification. In addition, the procedures set forth in proposed Rule 4007(c) do not afford firms an adequate opportunity to review draft inspection reports. Finally, we believe that proposed Rule 4007 should permit firms to comment on final inspection reports.

A. PROVISIONS PROTECTING CONFIDENTIALITY MUST BE CLARIFIED

As an initial matter, the Board states in the "Section-by-Section Analysis" of the Release that it would automatically keep confidential, without the need for a specific request by a firm, any portions of a firm's response to a draft inspection report that address criticisms of and potential defects in the firm's quality controls.[11] However, the "Section-by-Section" analysis seemingly conflicts with the note to proposed Rule 4007(b), which states that the Board will

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[11] Release at A2-vii.

protect information in a firm's response to a draft inspection report from disclosure "only if it is reasonable to characterize the information as confidential." The confidentiality that the Board intends to afford to portions of a firm's response that address criticisms of and potential defects in its quality controls should be explicitly set forth in the text of Rule 4007.

Moreover, the Board offers no guidance in the proposed rule or the accompanying note as to when it would be "reasonable" to consider information confidential. The process of reviewing and responding to draft inspection reports can be meaningful only if firms have the freedom to be candid in their responses. In situations where responding accurately and completely to a draft inspection report would necessitate the disclosure of confidential information, a firm may be reluctant to respond—and potential errors or inaccuracies in the Board's report could go uncorrected—if a firm does not know what will be treated as confidential. To promote candor in the review process, the Board should provide firms with clear guidelines or examples as to when information (outside the quality control context, in which the Board has indicated that confidential treatment would be automatic) may reasonably be considered confidential.

In addition, the Board should confirm that firms are not required to provide supporting documentation to justify a request for confidential treatment. Based on the note to proposed Rule 4007(b), which states that a firm "may" supply such information, it is our understanding that supporting documentation is not required.

B. THE BOARD SHOULD STRENGTHEN ITS PROCEDURES FOR FIRM REVIEW AND COMMENT ON DRAFT INSPECTION REPORTS

We believe that proposed Rule 4007(c) does not afford firms adequate opportunity to review and to respond to draft inspection reports. Section 104(f) of the Act requires the Board's rules to provide a procedure for the review of and response to any draft inspection report. Proposed Rule 4007(c), however, provides that the Board "may, in its discretion, afford the firm the opportunity to review any revised draft inspection report." Allowing the Board discretion in

this regard does not comport with the clear mandate in Section 104(f) of the Act. Accordingly, proposed Rule 4007(c) should be revised to provide that firms must be given the opportunity to review and provide comments on all draft inspection reports (whether initial or revised).

Proposed Rule 4007(c) also goes beyond the Act by permitting the Board to "adopt[] [a] draft report as the final report" after receiving and reviewing any response letter submitted by a firm under proposed Rule 4007(b). Finalizing inspection reports under these circumstances, without any further communication between the Board and the firm that is the subject of the report, would result in a situation where a firm is left to wonder about the Board's views on its response letter and whether and how the firm's response will be reflected in the final inspection report. To prevent this result, the Board must provide the opportunity for a hearing or other review process prior to finalization of the report. This would allow a firm that has submitted a written response to a draft inspection report to participate in an interactive dialogue with the Board about any concerns articulated in the written response and to ensure that it has had an opportunity to respond fully to any issues identified in the draft report before the Board finalizes the report.

C. FIRMS SHOULD HAVE A RIGHT TO COMMENT ON THE FINAL INSPECTION REPORT

Once the Board has prepared a final inspection report, we believe that firms should be able to submit comments on the final report. In the event that a firm disagrees with any of the conclusions in the report, or believes that further clarification is appropriate, the firm should have an opportunity to document its views in writing and those views should accompany any public disclosure or referral of the report. For example, a disagreement between the Board and a firm over the adequacy of particular aspects of the firm's quality control systems might be viewed differently by the relevant state accounting authority if the authority had access to the views of both the Board and the firm.

IX. Proposed Rule 4008 Transmittal of Final Inspection Report

Proposed Rule 4008 mandates that the Board transmit copies of final inspection reports to the SEC and (in appropriate detail) relevant licensing and certification authorities,[12] and permits, but does not require, the Board to include in the transmittal "any additional letter or comments by the Board or the Board's inspector that the Board deems appropriate." If, as we suggested in our comments on proposed Rule 4007, the Board determines that firms should have the opportunity to comment on final inspection reports, we believe that the full text of any firm comments should be transmitted along with any final report.

In addition, proposed Rule 4008 should explicitly confirm that the transmission of final inspection reports is subject to the confidentiality provisions in Section 105(b)(5)(B) of the Act. Moreover, although we understand that making final inspection reports available to the SEC and other agencies, as well as to the public, is contemplated by the Act,[13] we are concerned that, unless clarified, such availability may be administered in a manner inconsistent with the Act's provisions protecting the confidentiality of this information. We suggest the following revisions in order to ensure that final inspection reports remain confidential and privileged, even when provided to the agencies listed in the Act, to the extent information contained in the reports is not otherwise disclosed to the public. We believe that these revisions are strongly supported by the

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[12] Proposed Rule 4008(c) specifies those authorities other than the SEC to which the Board must transmit copies of final inspection reports, in appropriate detail, and includes "each state, agency, board, or other authority that has issued a license or certification number authorizing the firm to engage in the business of auditing or accounting."

[13] *See* Act, § 104(g).

Act, which states that "each of [the agencies receiving final inspection reports] shall maintain such information as privileged and confidential."[14]

First, the Board should release final inspection reports to another agency only under a confidentiality agreement. Section 105(b)(5)(A) of the Act states that inspection-related documentation and information shared with an agency "shall be confidential and privileged *as an evidentiary matter* (and shall not be subject to civil discovery or other legal process) in any proceeding in any Federal or State court or administrative agency." Although this provision may prevent state or federal agencies from introducing final inspection reports *as evidence in judicial or administrative proceedings*, proposed Rule 4008 does not explicitly prevent such an agency from disclosing the report to the public on its own initiative. If the Board were to require agencies to enter into confidentiality agreements as a condition of receiving final inspection reports, that agreement would bar agencies from releasing the reports to the public, and would thereby carry out Congress's mandate that agencies keep this information confidential. Alternatively, the Board could specify explicitly in its rule that a receiving agency is prohibited from disclosing final inspection reports to anyone outside the receiving agency and could require the Board's staff to advise the recipient agency of these obligations.

Second, the final rule should explicitly confirm that state law is preempted to the extent that state law would otherwise require a state agency in receipt of a final inspection report to disclose it. Section 105(b)(5)(A) of the Act states that documents and information prepared or received by or specifically for the Board in connection with an inspection "shall be exempt from disclosure, in the hands of an agency or establishment of the Federal Government, under the Freedom of Information Act (5 U.S.C. 552a), or otherwise." This language, however, does not

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[14] *Id*. § 105(b)(5)(B)(ii)(IV).

directly cover the status of the information in the hands of state attorneys general and other "appropriate State regulatory authorit[ies],"[15] including those authorities listed in proposed Rule 4008(c). Once the Board transmits a final inspection report to a state agency, the state agency might be required by various state "freedom of information acts" or similar state laws to disclose that information whether or not requested by the public.[16] Notwithstanding that final inspection reports are confidential under Section 105 of the Act, disclosure to a state agency may effectively subject such information to public discovery if the rule's language is not clarified. Accordingly, the final rule should expressly confirm that state law is preempted to the extent that it would otherwise permit or require the receiving state agency to disclose final inspection reports. Such a statement would faithfully implement the Act's requirement that receiving state agencies "maintain such information as confidential and privileged."

The Board also should ensure that its comments or letters submitted with the final inspection report are treated confidentially. In this regard, Proposed Rule 4008 should also be revised to confirm that additional letters or comments of the Board are not deemed to be part of any final inspection report. As a result, additional letters and comments would remain confidential in accordance with Section 105(b)(5)(A) because they constitute information prepared by the Board in connection with an inspection. If the Board should disagree and take the position that additional letters or comments are not confidential, the rule should provide that the firm has the same rights with respect to these communications that we believe the Board should provide for final inspection reports – that is, the right to respond in writing to the letters

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[15] *Id*.

[16] *See*, *e.g.*, Cal. Gov't Code § 6250 *et seq.*; Tex. Gov't Code § 552.001 *et seq.*; 5 Ill. Comp. Stat. 140/1, *et seq.*; N.Y. Pub. Off. Law § 84, *et seq*. Even if the agency decided not to disclose this information to the public, public interest groups and private litigants could still seek this information in the absence of preemption.

or comments, and to have its response accompany any public disclosure or referral of the letters or comments.

X. Proposed Rule 4009 Firm Response to Quality Control Defects

Proposed Rule 4009 outlines the procedure by which firms can provide evidence to the Board that criticisms of and potential defects in their quality control systems contained in a final inspection report have been improved and remedied, as appropriate. Because the failure to address criticisms and potential defects "to the satisfaction of the Board" will result in public disclosure of those criticisms and potential defects, we believe that certain modifications to the rule are necessary in order to ensure fair and accurate reporting to the public.

First, the Board should provide guidance as to the meaning of the phrase "criticisms of, or potential defects in, the quality control systems of the firm under inspection."[17] A lack of clarity regarding the scope of this phrase will result in inconsistencies in the inspection process and in determinations regarding the quality control issues that should be documented in inspection reports. Additionally, the Board should be able to distinguish between minor infractions and those that are significant.

Second, once a firm submits evidence that it has improved its quality control systems and remedied any potential defects, but before the Director of the Division of Registration makes its final recommendation to the Board, the Board should provide the opportunity for a hearing or other review process in instances where there is uncertainty about whether the firm has in fact made the appropriate improvements or remedied any potential defects. Where a firm makes a good faith effort to address criticisms of or potential defects in its quality control systems, fairness and equity dictate that the firm should have the opportunity to communicate with the

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[17] *See* Proposed Rule 4009.

Director about the sufficiency of its corrective measures, and any additional modifications the Director believes may be necessary, prior to the Board's final determination. If the firm becomes aware of additional relevant information after the Director makes a recommendation to the Board, the firm should also have the opportunity to present information to the Board at that time.

Third, the Board should not be able to publish criticisms of or potential defects in a firm's quality control systems when the firm has requested SEC review of a final Board determination that the firm has not addressed these criticisms or defects to the Board's satisfaction. As drafted, proposed Rule 4009(c)(3) would permit the Board to make quality control information public 15 days after a firm requests SEC review unless the SEC directs otherwise. To publish quality control information while the SEC's review is ongoing could cause irreparable harm to a firm, would be unfair and inequitable, and would not be in the public interest or consistent with the Board's mission. Section 104(h)(1) of the Act provides for the SEC to promulgate rules governing the SEC review process. Although the SEC has not yet proposed rules in this area, it is virtually certain that the review process will take more than 15 days, and the SEC may well conclude following a review that a firm has adequately addressed any criticisms or potential defects in its quality control systems. Accordingly, the SEC should be allowed adequate time to conduct its review, and information about any criticisms of or potential defects in a firm's quality control systems should be kept confidential pending completion of the review.[18]

Fourth, proposed Rule 4009 should be revised to incorporate the requirements of Section 104(g)(2) of the Act, which contains an absolute prohibition on disclosing portions of a final

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[18] The Board may believe that the 15-day provision gives the SEC adequate time to direct otherwise. In practice, however, hard-pressed professionals at the SEC will not be able to meet such short deadlines. Also, longer periods for consideration will lead to better and more finely calibrated regulatory outcomes.

report that deal with potential defects in quality controls systems if they are addressed to the Board's satisfaction no later than 12 months after the date of the inspection report. To avoid potential breaches of confidentiality, proposed Rule 4009 should expressly prohibit any recipient of a final inspection report under proposed Rule 4008, including the SEC and relevant licensing and certification authorities, as well as the firm that is the subject of the report, from disclosing sections of the report or of any additional letters or comments accompanying the report, that discuss criticisms of or potential defects in quality control systems, until disclosure is otherwise authorized under Rule 4009.

Fifth, the Board should confirm that the confidentiality afforded by proposed Rule 4009 extends not only to the portions of an inspection report that discuss criticisms of or potential defects in quality control systems, but also to any transmittal letter or other communication notifying a firm of a final determination by the Board, in accordance with proposed Rule 4009(b), that a firm has not addressed those criticisms and potential defects to the Board's satisfaction. If the Board disagrees that the transmittal letter is confidential, the rule should provide that the firm has the same rights with respect to the letter that we believe the Board should provide for final inspection reports – that is, the right to respond in writing to the transmittal letter and to have its response accompany any public disclosure or referral of the letter.

Sixth, as currently drafted, proposed Rule 4009(c) affirmatively provides that the portions of a final report dealing with quality control criticisms and potential defects will be made public upon the occurrence of certain events. We believe that the proposed rule should provide that the relevant portions of the report will not be made public until the last to occur of: (1) the expiration of the 12-month period after the issuance of a final inspection report (if a firm fails to respond to the report); (2) the expiration of the 30-day period during which a firm may seek SEC review of

a final Board determination that the firm has not responded to potential quality control defects or criticisms identified by the Board; or (3) the conclusion of the SEC review process.

Finally, prior to the Board's public disclosure of criticisms and potential defects relating to a firm's quality control systems, the firm should have the opportunity to respond to the proposed disclosure. The firm's response should be included in the disclosure when it is made public.

XI. PROPOSED RULE 4010 BOARD PUBLIC REPORTS

Proposed Rule 4010 does not accord appropriate weight to confidentiality concerns and should be modified in several respects to address these concerns.

Proposed Rule 4010 should be revised to incorporate by reference the restrictions on disclosure of confidential information mandated by Section 104(g)(2) of the Act, which governs public disclosure of final inspection reports. Section 104(g)(2) requires the Board to make final inspection reports available to the public in appropriate detail, subject to exclusions for confidential information, information prepared or received by or specifically for the Board (as set forth in Section 105(b)(5)(A) of the Act), and portions of reports that deal with criticisms of or potential defects in a firm's quality control systems. Although proposed Rule 4010 implements Section 104(g)(2), the proposed rule makes no mention of the statutory provision regarding confidentiality.

In addition, the Board should clarify whether, and to what extent, proposed Rule 4010 permits publication of information that the Board is restricted or prohibited from disclosing under proposed Rules 4007, 4008 and 4009. Proposed Rule 4010 permits the Board to publish reports about Board procedures, findings, and inspection results "[n]otwithstanding any provision of Rules 4007, 4008, and 4009." Accordingly, the proposed rule appears to permit the Board to disclose to the public: (1) information contained in draft inspection reports (proposed

Rule 4007); (2) information that firms include in their responses to draft inspection reports and that the Board has agreed to treat as confidential (proposed Rule 4007); (3) information contained in final inspection reports that the Board has the option of not transmitting to state licensing and certification authorities, if it could interfere with investigations, prosecutions, or disciplinary proceedings (proposed Rule 4008); and (4) certain information about criticisms of and potential defects in quality control systems (proposed Rule 4009). Moreover, the prohibition in proposed Rule 4010 on disclosure of firm-specific information covers only information pertaining to potential defects in and criticisms about quality controls.

We believe that public disclosure of certain information that is otherwise exempt from disclosure under proposed Rules 4007, 4008 and 4009 would be wholly inappropriate because it would be inconsistent with the requirements of the Act and other provisions of the proposed rules. Draft inspection reports, which are covered by proposed Rule 4007, are confidential under the plain language of Section 105(b)(5)(A) of the Act because they constitute "information prepared . . . by . . . the Board . . . in connection with an inspection." Moreover, we do not believe that the Board should have the authority under proposed Rule 4010 to disclose publicly information contained in a draft inspection report before a firm has had the opportunity to respond to the report in accordance with the procedures set forth in proposed Rule 4007(b). Similarly, allowing the Board to disclose under proposed Rule 4010 information in a firm response to a draft inspection report, when Section 104(f) of the Act requires that the text of the firm's response be "appropriately redacted to protect information reasonably identified . . . as confidential" and the Board has agreed to keep that information confidential, would eviscerate the protections afforded to firms under the confidentiality provision in proposed Rule 4007(b).

With regard to proposed Rule 4008, the Board should not have the authority to make public disclosure under proposed Rule 4010 of information that it determines not to share with

state licensing and certification authorities because of the risk that doing so would interfere with an investigation, prosecution or disciplinary proceeding. With regard to proposed Rule 4009, Section 104(g)(2) of the Act expressly states that "no portions" of an inspection report that deal with criticisms of or potential defects in a firm's quality control systems can be made public if they are addressed to the Board's satisfaction no later than 12 months after the date of the inspection report. In view of the clear statutory requirement, which is reflected in proposed Rule 4009(c)(1), we do not believe that the Board has the authority to make even generalized disclosures about criticisms of or potential defects in quality controls systems until this 12-month period has expired and a firm has failed to address the criticisms or potential defects and has exhausted any SEC review procedures that it intends to pursue. Moreover, we have concerns that permitting disclosure under proposed Rule 4010 of even general information about criticisms of and potential defects in the quality control systems of ostensibly unnamed firms could result in disclosure of a firm's identity. For these reasons, we believe that the Board's authority under proposed Rule 4010 to make public disclosure of procedures, findings and inspection results should be subject to, rather than exempt from, the confidentiality provisions in proposed Rules 4007, 4008 and 4009.

It would also be appropriate to keep confidential for a limited time period any information relating to audit engagements that are the subject of ongoing litigation or controversy between a firm and one or more third parties. Section 104(d)(1) of the Act and proposed Rule 4001 permit the Board to inspect and review such engagements as part of its broader inspection authorities. However, because of the possibility that even general disclosures could reveal a firm's identity or adversely impact a pending or possible legal proceeding, information about audit engagements that are the subject of ongoing litigation or controversy should remain confidential until the conclusion of the litigation or controversy.

Finally, if the Board disagrees with the points expressed in part IV of this letter and determines that its authority to conduct regular inspections under Section 104(d)(1) and proposed Rule 4001 covers ongoing engagements, we believe it would be appropriate to keep confidential information relating to any engagement that has not been completed at the time it is subject to inspection, until the engagement has concluded.

CONCLUSION

Due to the short time frame within which the Board has requested comments and the complicated nature of the proposed rules, it may be useful to discuss these issues with you further. If you have any questions or would like to discuss these issues further, please contact Robert J. Kueppers at (203) 761-3579.

Very truly yours,

/s/ Deloitte & Touche LLP

cc: William J. McDonough, Chairman
Kayla J. Gillan
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VIA ELECTRONIC FILING AND HAND-DELIVERY

August 18, 2003

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Public Company Accounting Oversight Board
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Washington, D.C. 20006-2803

PCAOB Rulemaking Docket Matter No. 006,
Proposed Rules on Inspections of Registered Public Accounting Firms

Dear Sir or Madam:

Ernst & Young is pleased to submit these comments on the Public Company Accounting Oversight Board's proposed rules regarding the inspection registered public accounting firms.

The inspection process is a fundamental component of the PCAOB's mission. We believe that the PCAOB's rule proposals largely reflect the requirements set forth in the Sarbanes-Oxley Act ("the Act") and will provide for fair and meaningful inspections. It is in our best interest, as the auditor of more than 2500 public companies in the United States, to make sure that all aspects of our auditing and quality control processes are the highest quality possible. We expect that the PCAOB's inspections will assist us in finding areas where we can improve our performance.

We do, however, have comments on several elements of the rule proposals. They are set forth below.

1. **Proposed Rule 4000 (General)**: The proposal states that inspections shall be performed by PCAOB staff "and by such other persons as the Board may authorize to participate in particular inspections or categories of inspections." The employment status of these "other persons" is not described. In view of the confidentiality of documents and other information that will be available to the inspection team, the PCAOB should make clear that any outside contractors employed by the PCAOB will be subject to the confidentiality requirements applicable to PCAOB members and staff.

2. **Proposed Rule 4002 (Special Inspections)**: Consistent with Section 104(b)(2) of the Act, the proposed rules provide for "special inspections" of registered firms. The proposing release (at page 7) states that such inspections may be prompted by "information that comes to the attention of the Board or its staff in any way, including public company filings with the Commission, news reports and matters brought

informally to the attention of the Board's staff by other regulators, professional associations, informants, and members of the public."

We are concerned about the open-ended nature of the "special inspection" procedure and the lack of clear dividing lines between such inspections and Board informal investigations, which will be governed by a separate, and much more detailed, set of rules (*see* Proposed Rules on Investigations and Adjudications, PCAOB Rulemaking Docket Matter No. 005). The Board should make clear that special inspections 1) are not intended to supplant the Board's investigative rules and procedures, and 2) are designed to address systemic issues relating to a firm's quality control or auditing procedures rather than individual audit failures or other client-specific matters.

3. **Proposed Rule 4004 (Procedures Regarding Possible Violations):** Section 104(c) of the Act provides that if the Board identifies a possible violation of a rule or a professional standard during an inspection the Board shall report that finding "to the Commission and each appropriate State regulatory authority." The rule text essentially tracks the proposed rule. However, in the rulemaking release (at page 8) and in a note to Rule 4004 the Board states that it intends to make referrals to persons "other than those specifically described in Rule 4004," such as the broader range of persons identified in Section 105(b)(5)(B), relating to violations that are found during investigations – that is, the Department of Justice, federal banking agencies, state attorneys general, and any appropriate State regulatory authority. Because Congress clearly specified a different set of entities to whom referrals might properly made after inspections and investigations, it seems inappropriate for the Board to adopt the broader list in Section 105(b)(5)(B) and likewise to state that it might provide information about possible violations to persons "other than those specifically described in Rule 4004." Presumably, and quite reasonably, Congress believed that routine inspections should not expose registered firms to as large an array of possible collateral proceedings as those appropriate for violations discovered during investigations.

   In addition, we urge the Board to make clear that it will not refer any "possible violation" to the Commission and other authorities. That is a low threshold. We would expect that significant possible violations might properly be referred to the Board's investigative staff, and then perhaps to the Commission and other authorities if unusual circumstances warrant such additional regulatory involvement. The "possible violation" threshold is particularly troublesome if the Board were to leave unchanged the open-ended nature of the referral process described in the preceding paragraph.

   Finally, we suggest that the Board establish a procedure where it would notify the firm whenever it intends to refer a possible violation to the SEC. It would also be helpful in our view for the Board to establish a procedure where the firm is given an opportunity to discuss the matter with the Board's staff – perhaps even to allow Wells-type submissions – prior to referral to the Commission.

4. **Proposed Rule 4006 (Duty to Cooperate with Inspectors):** The proposal would require a registered accounting firm to provide "any" documents or other information that "may be requested by the Board's inspectors and that the Board considers relevant or

material to the subject matter of the inspection." This is a very broad provision. It suggests, for example, that even though the inspection process is intended to determine the registered firm's compliance with rules and standards with respect to *issuers* or *U.S. public companies* (see, e.g., rule release, pages 1 and 2), the Board might request information relating to audits of non-issuers if such information might be "relevant" to the Board's inspection. We urge the Board to clarify, consistent with the standard established under Section 104(a) of the Act, that materials "relevant or material" to the subject matter of an inspection would, by definition, specifically relate to a registered public accounting firm's compliance with the Act, Board or SEC rules, or applicable professional standards relating to the firm's performance of audits, issuance of audit reports, or related matters involving issuers.

In addition, certain sensible limitations should be imposed on the types of information that are subject to inspection. For example, the PCAOB's final rule release should make clear that the Board does not interpret the Act as having abrogated the attorney-client or other privileges, and that attorney-client communications and attorney work-product documents are not subject to inspection. Personal information, such as partners' or employee's medical records, also should not be subject to inspection.

5. **Proposed Rule 4007 (Procedures for Firm Review of and Response to Draft Inspection Report and Issuance of Final Inspection Report)**: We have three comments this rule proposal.

   First, it would appear that the Board intends to issue separate reports for regular and special inspections, but this should be clarified.

   Second, paragraph (c) of the proposal allows the inspected firm to comment on a draft report but states only that the Board "in its discretion" may give the inspected firm an opportunity to comment on a revised draft prior to the Board's issuance of a final report. We believe that the firm should be allowed to respond to the revised draft report to the extent significant changes have been made in it. This is particularly appropriate because the rule release states (at page 8) that "[t]he firm's response to the draft inspection report shall be attached to and made part of the inspection report " – if significant changes have been made from the initial draft, then the firm's comment letter should respond to the revised draft as well as to the final inspection report if different from the revised draft. We further note that the rule text itself (as opposed to the rule release) does not state that the firm's response to the report will be attached to the final report; the Board should include a description of that process in the rule text.

   Third, the proposal should make clear that draft reports and responses to those reports, as well as related documents, are within the scope of the confidentiality/privilege protections of Section 105(b)(5)(A) of the Act because, as that provision sets forth, they are documents "prepared . . . [and] received by . . . the Board" and are "prepared . . . specifically for the Board" in connection with a Board inspection.

6. **Proposed Rule 4008 (Transmittal of Final Inspection Report):** The proposal provides that the final report will be sent to the inspected firm, the Commission, and state

regulators. The proposal further states that "the report may be accompanied by any additional letter or comments by the Board or the Board's inspector that the Board deems appropriate." We are concerned that this procedure could circumvent the procedures required by the Act and set forth in Rule 4007 by which the inspected firm will have the opportunity to respond to matters being reported by the Board. Substantive issues relating to the inspection should be addressed in the report itself, not in the transmittal letter. Alternatively, the inspected firm should be given an opportunity to review and comment on such letters before they are finalized.

In addition, the proposed rule seems to provide for broader dissemination of the inspection reports than is required by the Act. The proposal states that the Board will issue inspection reports "in appropriate detail, to each state, agency, board or other authority that has issued a license or certification number authorizing the firm to engage in the business of auditing or accounting." By contrast, Section 104(g)(1) of the Act only provides for disclosure to "each appropriate State regulatory authority," which Section 2(a)(1) of the Act defines as "the State agency or other authority responsible for the licensure or other regulation of the practice of accounting in the State or States having jurisdiction over a registered public accounting firm . . . with respect to the matter in question." It seems doubtful that a regulatory agency in, for example, New Mexico has "jurisdiction over a registered public accounting firm . . . with respect to" conduct that occurs in and affects a company in, for example, Pennsylvania. Although perhaps implicitly addressed by the proviso that the states need only receive copies of inspection reports "in appropriate detail," the proposed rule should be revised explicitly to reflect that copies of inspection reports will not be sent to states which have no significant regulatory interest over the matter addressed in the report.

7. **Proposed Rule 4009 (Firm Response to Quality Control Defects):** This rule provides the procedure for firms to provide to the Board evidence of improvements made in response to criticisms or defects found by the Board during the inspection. It states that, after reviewing such evidence, the Director of the Division of Registration and Inspections shall advise the firm of his or her conclusion as to whether the firm has satisfactorily addressed the criticisms or defects; that he or she will make a recommendation to the Board in this regard; and that the Board will then notify the firm of its final determination. As proposed, this procedure does not provide for any input from the firm. We believe that we should be able to respond formally whenever the Director determines that we have not satisfactorily addressed criticisms or defects identified in the inspection process.

8. **Additional issues:** We have several additional suggestions, which largely reflect our understanding of practices used by the SEC in its inspections of regulated entities.

   First, routine inspections should not be commenced without prior notice, which should be provided at least three weeks prior to the commencement of the inspection. We also urge that the Board not conduct "surprise" inspections except in extraordinary circumstances. A firm should be given the opportunity to gather documents, set aside office space, ensure that relevant personnel are available, and otherwise prepare itself for the inspection. Providing such preparation time facilitates an efficient and thorough

inspection. The only reason for a surprise inspection of which we are aware is where there is concern that a firm might destroy or alter relevant documents. In view of the "death penalty" impact that such a course of action would have on an accounting firm and its personnel – potential criminal liability, loss of licenses, and so on – the Board need not realistically be concerned that any reputable accounting firm would engage in such illegal activity.

Second, the firm should have a right to request at least one postponement of a routine inspection for good cause.

Third, visits to satellite offices during the inspection should always be preceded by notice to the firm's headquarters.

Fourth, all inspections should be completed within a set time.

Fifth, the PCAOB should recognize that the firm being inspected has a right to have its legal counsel present during the inspection.

Sixth, a specific person at the PCAOB should be designated to resolve disputes that may arise during an inspection.

* * *

We appreciate the opportunity to provide these comments, and we would welcome discussion of any points that require further explanation.

Respectfully submitted,

Ernst & Young LLP

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August 15, 2003

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Re: Proposed Rules on Inspections of Registered Public Accounting Firms (PCAOB Rulemaking Docket Matter No. 006)

Dear Secretary:

As the Director for International Financial Markets of the Financial Services Agency of Japan (" FSA "), I am pleased to submit this letter on behalf of the FSA in response to the request of the Public Company Accounting Oversight Board ("PCAOB") for comments on the Proposed Rules on Inspections of Registered Public Accounting Firms ("Proposed Rules") as contained in PCAOB Release No. 2003-013 (July 28, 2003)("Release") .

(Importance of dialogues and cooperation between the PCAOB and the FSA)

We appreciate that the PCAOB acknowledges in the Release special issues relating to Non-U.S. firms and the need for dialogues between the Board and its foreign counterparts. Such acknowledgement by the PCAOB is consistent with the acknowledgement, encouragement and urge by the Securities and Exchange Commission ("SEC") contained in its Release No. 34-48180 in which the SEC granted approval of the PCAOB's proposed rules relating to registration system. As the auditor oversight body in Japan, the FSA is also willing to continue constructive and practical dialogues and cooperation with the PCAOB in order to solve the serious issues of the oversight over the Japanese audit firms by the PCAOB in a mutually satisfactory way. My visit to the PCAOB at the end of June was a first step toward such purpose.

(Request for an appropriate exemption from the oversight by the PCAOB)

The PCAOB's oversight, including inspections, of foreign public accounting firms would raise a much more serious problem than the registration requirement. This raises not only the issue of imposing "unnecessary burdens or conflicting requirements" as stated by the SEC and PCAOB, but also the *more fundamental issue concerning the need to respect foreign jurisdictions' sovereignty and equivalent auditor oversight systems,* as shown in our public comment letter to the PCAOB dated March 28 and as I mentioned at the Roundtable on Registration and Oversight of Non-U.S. Public Accounting Firms on March 31. We would like to add that on May 30 the Japanese Diet passed a bill for the comprehensive revision of the Japanese CPAs Law, and through this revision, which will become effective next April, the Japanese auditor oversight system will be even more substantially equivalent to that provided under the Sarbanes-Oxley Act.

Japanese audit firms should not be subject to the oversight powers of the PCAOB. Legal powers of the PCAOB, including inspections, should not be, and could not be, conducted or enforced within the Japanese jurisdiction as a matter of sovereignty. In addition, since the FSA and CPAAOB (CPAs and Auditing Oversight Board) to be established next April under the revised CPAs Law have the power to inspect Japanese audit firms, and the JICPA (Japanese Institute of CPAs) will regularly conduct audit quality control review of Japanese audit firms under the oversight by the CPAAOB, *it is not necessary or appropriate for the PCAOB to conduct inspections, in particular regular inspections, of Japanese audit firms.* I would like to add that all of the Japanese audit firms which audit issuers are subject to the review by the associated large U.S. public accounting firms, of which the PCAOB can conduct inspections.

From this viewpoint, there is a problem in the Proposed Rules because they do not include any provision to deal with non-U.S. firms, including Japanese audit firms. Although the Release states that "the Board's proposed rules are not intended in any way to signal that the Board has already determined how its oversight should operate as to those firms, or to preclude any adjustments to the rules that may be appropriate in light of those discussions," non-U.S. firms would be subject to the same inspections by the PCAOB as the U.S. firms if the Proposed Rules were not adjusted. Such an outcome would not be in line with the emphasis by the SEC and the PCAOB on dialogues with foreign counterparts. The sequence of steps which should be taken should be as follows:

・ First, registered foreign accounting firms should be exempted from the Proposed Rules.
・ Second, the PCAOB and its foreign counterparts (the FSA and the JICPA) should continue dialogues and reach a mutually satisfactory conclusion.
・ Third, the PCAOB's Rules on Inspections of Registered Public Accounting Firms should be adjusted as necessary based on the above conclusion.

Therefore, *we respectfully request the PCAOB to provide an appropriate exemption from the Proposed Rules to Japanese audit firms.*

(Request for providing an exemption from the duty to cooperate with inspectors)

Based on this premise, we would like to make further comments on the Proposed Rules.

The PCAOB's effective Registration Rules include the provision (Rule 2105) that allows an applicant to withhold information from its application for registration when submission of such information would cause the applicant to violate a non-U.S. law if that information were submitted to the PCAOB. The same kind of provision to deal with conflicting non-U.S. laws (such as the duty to keep confidentiality of information under the Japanese CPAs Law) is necessary with regard to the proposed duty to cooperate with inspectors under Rule 4006 of the Proposed Rules.

Therefore, *we respectfully request the PCAOB to provide an appropriate exemption from the duty to cooperate with inspectors in case such action conflicts with non-U.S. laws*.

(Conclusion)

We respectfully request that the PCAOB will take full account of our comments in promulgating the final rules.

Yours Sincerely,

Naohiko MATSUO
Director for International Financial Markets
Financial Services Agency, Japan

INSTITUT
DER
WIRTSCHAFTSPRÜFER
IDW

August 18, 2003

Office of the Secretary
PCAOB
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Washington, D.C.20006-2803
USA

Dear Sirs

Re.: PCAOB Rulemaking Docket Matter No. 005
Proposed Rules on Investigations and Adjudications

PCAOB Rulemaking Docket Matter No. 006
Proposed Rules on Inspections of Public Accounting Firms

PCAOB Rulemaking Docket Matter No. 007
Proposed Rule on Withdrawal from Registration

The Institut der Wirtschaftsprüfer [German Institute of Public Auditors] (IDW) is pleased to have the opportunity to comment on the PCAOB's proposals (the Proposed Rules on Investigations and Adjudications, Inspections of Public Accounting Firms and Withdrawal from Registration) for oversight over non-U.S. accounting firms that audit the financial statements of U.S. public companies. We would like to assure you that, as noted in previous correspondence, we share U.S. concerns regarding investor confidence and support the objectives of the Sarbanes-Oxley Act, if not all of the individual provisions of the Act or the rules or proposed rules for its implementation. We agree with the PCAOB's stated commitment to finding ways of accomplishing the goals of the Sarbanes-Oxley Act in respect of inspections of registered public accounting firms without subjecting non-U.S. firms to unnecessary burdens or conflicting requirements.

We understand that the next meeting of representatives of the PCAOB with representatives of the EU Commission will take place in September 2003 and presume that this meeting will continue and enhance the dialogue that has been taking place

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between the EU Commission and the PCAOB on issues of mutual concern in relation to the Sarbanes-Oxley Act. In this context, we are pleased to note the PCAOB's commitment to dialogue between the PCAOB and its foreign counterparts in item 6 of Docket No. 5 and item 7 in Docket No. 6.

In our opinion, the proposed dialogue on the currently proposed rules is absolutely necessary because the German legal system differs so significantly from that of the U.S., that implementation in Germany of certain provisions of the Sarbanes-Oxley Act, in particular, numerous aspects of the proposed rules relating to inspection, investigation and adjudications would be legally impossible and implementation of others would place extremely onerous burdens on German public accounting firms.

However, we would like to express our disappointment that the PCAOB did not seek to follow the recommendations of ECOFIN and the European Commission to provide an exemption for registration with the PCAOB for public accounting firms in the European Union as would have been permitted under Section 106. (c) of the Sarbanes-Oxley Act. We would like to point out that such an exemption based upon the recognition of the establishment of appropriate enforcement and oversight mechanisms by national governments and regulatory authorities in the European Union would have obviated the need for complex dialogue on the many difficult implementation issues associated with the proposals noted above.

Given the major adjustments that we believe are necessary due to the impact of the proposed rules on German public accounting firms we will limit our comments to general concerns arising from the proposed rules by addressing the major problem categories by means of examples. These examples do not purport to be an extensive or complete list of all such matters, but are intended as an illustration of the complexity of the issues that must be taken into consideration.

Confidentiality and Consent to Waiver by Client

In Germany the auditing profession is subject to professional confidentiality obligations set forth in the legislation governing the profession and audits of financial statements. This legislation prevents our members from providing the PCAOB, as a third party, access to any or all facts and circumstances with which they are entrusted or of which they become aware during the course of their professional work. The German Penal Code makes undue disclosure by an accountant a criminal offence [§ 203 Strafgesetzbuch]. Furthermore, the contract between a public accountant and the client carries an implied duty of confidentiality.

The confidentiality restrictions can only be waived with consent of the client; data security restrictions (see the treatment of data security below) would require the con-

sent of all those whose data is affected. For such consent by a client to be valid, the client must have a proper understanding of the scope of the information, the disclosure of which he or she is permitting. The PCAOB does not propose to limit the scope of information to which it has access, but rather intends to exercise its discretionary powers. Consequently, the courts in Germany would view this "proper understanding" test as not having been met.

Furthermore, client waivers of confidentiality restrictions do not in any way diminish the testimonial or documentary privileges of the public accountant (see below).

Testimonial and Documentary Privilege

The German public accountant is afforded the right to refuse to testify in civil, criminal and tax proceedings (testimonial privilege). Similarly, legislation (§ 97 Strafprozessordnung) prohibits the seizure of his working papers in criminal proceedings to the extent that the public accountant has exercised his right to refuse to testify. German civil procedure is similarly restrictive. Some of these restrictions on criminal proceedings and civil procedure are in part based upon requirements of the German Constitution and its interpretation by the German constitutional court and cannot be changed by an act of the Federal Parliament alone.

The rules allowing the PCAOB to call persons to testify also pose a problem. An employer in Germany is unlikely to be able to force an employee to testify unless this matter has been specifically addressed in the contract of employment. A further relevant factor is that in German employment law certain questions, mainly concerning criminal convictions, could be deemed inadmissible and therefore an employee may opt not to answer or may give a false answer. In such cases the law prohibits the employee from being exposed to any negative consequences from such refusal or false answer. A further factor is that in the event that a works council operates within a firm approval of that body is required before an employer can question its employees.

Hence, even if the legal confidentiality requirements were to be circumvented in some way, it is likely that data security legislation will prevent German public accounting firms from making information and documents available to the PCAOB.

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Data Security

In Germany, data protection legislation was amended in 2001 in order to implement the EC Directive 95/46/EC. A transfer of data under the German Data Protection Act would be deemed to have occurred if data were made available to the PCAOB either as part of the registration documentation or by permitting the PCAOB to conduct inspections on the firms' premises. Public accounting firms hold personal data relating to their staff, their clients, their clients' staff and third party individuals e.g. customers and suppliers of their clients.

Any consent to exception would be needed from every *individual* affected, and specifically not only the corporate clients. Further legal restrictions apply; the consent must be freely given, specific and informed. These definitions are subject to legal interpretation. Furthermore, consent must be express and in writing. This would create an extremely onerous obligation for public accounting firms.

Even if consent were to be obtained from those affected, the German courts may well not interpret such consent as having been freely given, due to the employee-employer relationship.

Considerations of personal interest, privacy rights and the overriding concept of "legitimate interest" sensitive data, employee confidentiality, business secrecy and employment law liability complicate the matter further.

The German Data Protection Act only permits the processing of personal data required to meet German legal obligations. Foreign legal obligations are not recognized in this legislation. It should be noted that data security legislation in Germany is based on the German Constitution and jurisprudence.

Since the PCAOB is not in a position to deal with the intricacies of investigations or inspections within a German legal context, we believe that it would be in the interest of the SEC and the PCAOB to engage in constructive dialogue with both the European Commission and German authorities, regulators and oversight bodies to see whether arrangements of mutual benefit could be established.

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We hope that our comments will be useful in your assessment of the nature and extent of the problems involved in applying in a German legal context what are essentially rules and statutes designed for a U.S. legal environment. Consequently, we believe it to be in our mutual interest that the PCAOB give the concerns we have due consideration. We would be pleased to be of assistance in these matters.

Yours truly

Klaus-Peter Naumann
Chief Executive Officer

495/541

18 August 2003

DJI/AMB/rmp

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Office of the Secretary
PCAOB
1666 K Street NW
Washington DC
20006-2803

By e-mail: comments@pcaobus.org

Dear Sir

PCAOB RULEMAKING DOCKET MATTER 006
PROPOSED RULES ON INSPECTIONS OF REGISTERED PUBLIC ACCOUNTING FIRMS

We welcome the opportunity to comment on the proposed rules relating to your inspection procedures. Our principal interest is in the potential impact on non-US accountancy firms, of which we are responsible for the registration and supervision of a significant number.

We note the reaffirmation in your consultation paper that the Board is committed to finding ways to avoid subjecting non-US firms to unnecessary burdens and conflicting requirements. We are therefore particularly pleased to see that the proposed rules do not signal that the Board has already determined how to apply oversight to non-US accounting firms. We look forward to constructive developments on these matters.

We note that the procedures proposed in many ways resemble those which our own monitoring unit has had in operation for some years and we have found these to work well. However, we do have a couple of brief comments on the detail that you may wish to consider.

Inspection Schedule

You note an intent to visit firms auditing more than 100 issuers annually, and other firms at least every three years. Proposed rule 4003 reflects this.

The distinction in visit scheduling between auditors of more than 100 issuers and others is, we assume, intended to ensure that more visits take place to firms with a higher risk profile. There are other aspects to assessing the degree of risk of poor quality audit work being carried out, e.g. press comment or complaints about a firm, whether the clients need specialist

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knowledge, sudden large changes in numbers of audits, lack of internal QC inspectors, etc. Your proposed Special Inspections allow you to do additional inspections where such factors come to light, but you may find in due course that some firms require visits more frequently while others have a low risk profile and need be visited less often. Your rule 4003 as drafted, will permit the former but has an absolute backstop of three years. You note that the Sarbanes-Oxley Act Section 104(b)(2) permits the Board to vary the inspection schedule if appropriate and you may wish to consider introducing more flexibility into the rule

Confidentiality of papers copied

Your proposed rule 4006 requires firms to provide access to, and the ability to copy, any records considered relevant. This is not an unreasonable requirement, but given various comments elsewhere in the consultation document about public disclosure by the Board, it is not absolutely clear to us whether any copies taken will be held in confidence. We assume this is the intention and it may be helpful to clarify this.

We would be happy to discuss any of these and other issues with you.

Yours faithfully

David Illingworth
President

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August 18, 2003

Office of the Secretary,
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006-2803
U. S. A.

Re: PCAOB Rulemaking Docket Matter No. 006

Dear Sirs/Madams,

We are pleased to make comments regarding the proposed rules on inspections of registered public accounting firms.

In our comment letter dated March 31, 2003, we argued that the U.S. law could not require Japanese professionals who are qualified under a Japanese law and provide professional services in Japan to register with the PCAOB and provide it with certain confidential information. We have been proposing that the PCAOB grant an exemption under Section 106 (c) of the Sarbanes-Oxley Act to the members of the Japanese Institute of Certified Public Accountants (JICPA) on the grounds that the auditor oversight system in Japan is essentially equivalent to that in the U.S. We believe that the auditor oversight system in Japan should be relied upon, which would eliminate the necessity of PCAOB inspection over Japanese public accounting firms.

We also believe that some proposed inspection procedures would constitute extraterritorial application of U.S. regulation. We again propose that careful consideration be given to auditor oversight mechanism as to non-U.S. public accounting firms.

As a matter of principle, we do not agree to PCAOB inspection requirements for Japanese public accounting firms. In addition to reiterating this position of ours, we would like to provide our opinion on Rule 4010.

Rule 4010 "Board Public Reports" permits the PCAOB to publish any summaries, compilations or other general reports concerning the findings and results of its various inspections at any time. But we believe it is unilateral and grossly unfair to certain registered public accounting firms when these firms try to remedy the quality control defects identified in the final inspection report. It is true that the PCAOB promises not to divulge the names of public accounting firms at which quality control defects were identified, as Rule 4010 specifies that "no such published report shall identify the firm or firms to which such criticisms relate, or at which such defects were found."

However, in a country like Japan where public company audit engagements are carried out by a very small number of firms, it would not be difficult to identify which firm is referred to in a summary or general report even when its name is not mentioned. We would like the PCAOB to provide for a clause that safeguards privacy and interest of public accounting firms when the PCAOB publishes summaries or general reports concerning findings and results of its inspection activities.

Yours sincerely,

Akio Okuyama,
President and CEO
The Japanese Institute of Certified Public Accountants

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August 18, 2003

Dear Mr. Secretary:

Rulemaking Docket Matter No. 006

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's (Board), *Proposed Rules on Inspections of Registered Public Accounting Firms,* (Proposed Rule) released July 28, 2003. The Proposed Rule has been issued pursuant to Section 104 of the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley).

The overarching objective of the provisions of Sarbanes-Oxley, including Section 104, is one of furthering the public interest through improving financial reporting, governance, and audit quality. We wholeheartedly support the efforts of the Board in striving to achieve this objective.

We respectfully present for your consideration our observations on the Proposed Rule, including suggestions that we believe will improve the overall quality and effectiveness of the final rule, consistent with the objectives of Sarbanes-Oxley. These suggestions are explained in the remainder of this letter.

Proposed Rule 1001 – Definition of Professional Standards

Proposed Rule 1001 carries over the definition of professional standards contained in Section 2(a)(10) of Sarbanes-Oxley. We request that the Board provide clarification as to the meaning of accounting principles "dealt with in the quality control system of a particular registered public accounting firm" in the context of professional standards. In conjunction with proposed Rule 4009 regarding required firm responses to inspection reports, it would appear that this definition may provide an incentive to a registered public accounting firm to adopt quality control procedures no more stringent than those externally mandated. This seems inconsistent with the overarching objectives of Sarbanes-Oxley.

As such, we recommend the Board clarify its position as to the ramifications of non-compliance with accounting principles "dealt with in the quality control system of a particular registered public accounting firm" in relation to those externally mandated and consider adopting two categories for reporting criticisms and deficiencies. We recommend that the category of criticisms and deficiencies related to non-compliance with accounting principles dealt with in the quality control system be stated as recommendations for improvement. Registered public accounting firms could be required to report on their responses to such recommendations but such responses would not require determination by the Board as to whether they satisfactorily addressed the criticisms or defects in order to preserve confidentiality. We believe such a reporting scheme would properly align the objectives of each registered public accounting firm and the Board without increasing the professional risk of a firm who has set standards that exceed the minimum quality control elements mandated.

Section 4. Inspections

Proposed Rule 4000 – General

We request that the Board provide by rule clarification regarding the "other persons" that they may authorize to participate in particular inspections or categories of inspections. We are concerned that the authority to appoint agents to carry out the responsibilities of the Board was not contemplated in Sarbanes-Oxley and we believe such assignment of the responsibilities specifically vested in the Board raises concerns regarding confidentiality of client and firm proprietary information as well as the objectivity and competence of the "other persons." In light of these concerns we believe that the Board should limit the involvement of "other persons" to specialists in such areas as may be required to assist the Board in specialized industries or application of professional standards thereon and that the final rule should specifically set forth the circumstances in which the Board may authorize "other persons" to participate in inspections. Furthermore, the rule should set forth the procedures that the Board will employ to ensure the competence and objectivity of the "other persons," and explicitly note that "other persons" will be required to adhere to the Board's Release No. 2003-008, *Ethics Code for Board Members, Staff and Designated Contractors and Consultants*.

Proposed Rule 4004 – Procedure Regarding Possible Violations

As compared to Section 104(c)(1) of Sarbanes-Oxley, Proposed Rule 4004 broadens the population of external parties for which the Board may report possible violations of the standards described in the Proposed Rule to include "any other person." We request that the Board clarify its intent and legal basis for proposing to expand Sarbanes-Oxley in this manner. We believe such expansion is inappropriate considering the objective of inspections stated in Section 104(a) of Sarbanes-Oxley, which is to assess the degree of compliance of registered public accounting firms with the standards set out therein.

Additionally, we request that the Board clarify both how it plans to classify identified or suspected violations, and the threshold that will apply in deciding which violations are reported or whether to commence an investigation. Having a defined and transparent process will ensure consistent application.

We believe the note to proposed rule 4004, which allows the Board to share information that indicates a possible violation of the standards with parties "other than those specifically described" in the Proposed Rule exceeds the authority explicitly granted in Section 104 of Sarbanes-Oxley and undermines the principle of confidentiality set forth in Section 105(b)(5)(B) of Sarbanes-Oxley. We believe the interests of the Board and registered public accounting firms would be better served by limiting the parties with which the Board shares information to the Commission and the appropriate regulatory authorities, as contemplated in Sarbanes-Oxley. The Commission and the appropriate regulatory authorities have existing processes to investigate and act on possible violations that protect the rights of the parties involved, while reserving the right to refer such information to other appropriate parties.

Proposed Rule 4005 – Record Retention and Availability

We recommend that any future rules that the Board proposes with respect to record retention and availability be consistent with the Commission's record retention rules set forth in Release Nos. 33-8180 and 34-47241.

Proposed Rule 4007 – Procedures for Firm Review of and Response to Draft Inspection Report and Issuance of Final Inspection Report

We have concerns regarding the inability of a registered public accounting firm to review a revised draft inspection report prior to its issuance and distribution as a final report under proposed Rule 4007. We believe that the Board should provide by rule for the review of a revised draft inspection report by the firm under review to ensure that the revised draft is consistent with facts and circumstances the firm believes are relevant to the matters discussed therein and to provide an opportunity for the firm's accompanying letter of response to completely and accurately address all matters included therein.

In our letter containing comments on the Board's Rulemaking Docket Matter No. 001 dated March 28, 2003, we expressed our belief that the best interests of the Board and the public are served by ensuring that the Board's rules and conduct comport with the standards of constitutional due process. We believe that the lack of a requirement for the Board to provide a final inspection report to the firm under review prior to issuance of the final report, and the lack of a process to arbitrate disagreements about the content of final inspection reports raise serious concerns about due process and is in direct contradiction to Section 104(h)(1)(A) of Sarbanes-Oxley.

We fully recognize that inspection reports will be a valuable tool to identify opportunities to improve our existing quality control process. We believe a formal process to resolve disagreements regarding the content of inspection reports would strengthen the reports and enhance the effectiveness of improving audit quality through the inspection process. Further regarding proposed Rule 4007, we believe the proposed 30 day window in which a firm is required to provide its response to a draft inspection report is not sufficient to assure a thorough, comprehensive response. We respectfully request that the Board extend the proposed time frame from 30 to 60 days. We believe such an increase will provide adequate opportunity to gather and assemble relevant information without sacrificing the timeliness or efficiency of the inspection process.

In the Proposed Rule, the Board also allows a firm to identify information that it wishes to keep confidential. We believe that the Board should issue guidelines with respect to information that it is willing to characterize as confidential and the basis for such treatment.

Proposed Rule 4008 – Transmittal of Final Inspection Report

We request that the Board clarify the types of information it contemplates including in the letters or comments accompanying the transmittal of the Board's report to the Commission or other authorized regulators and whether that information will go beyond the scope of what is covered in the report. Sarbanes-Oxley does not grant the Board authority to provide such additional letters and comments and we are concerned that such communication may not comport with the principles of due process described above.

Additionally, we request that the Board clarify what circumstances might exist and what information it envisions might need to be omitted from the report when it is transmitted to the authorities listed in proposed Rule 4008(c).

Proposed Rule 4009 – Firm Response to Quality Control Defects

The Proposed Rule does not include a characterization of potential violations, or clear definitions of the terms "criticisms" and "potential defects." We request that the Board provide more explicit guidelines on the characterization of potential violations, including definitions of the noted terms, and an understanding of how specifically the Board will comment on the quality control systems of registered firms.

Under proposed Rule 4009(a), the Director of the Division of Registration is responsible for reviewing evidence that a registered public accounting firm has improved its quality control system and remedied any noted defects no later than 12 months after the issuance of the Board's final inspection report of such firm. The Proposed Rule also states that "the Director shall advise the firm whether he or she will recommend to the Board that the Board determine that the firm has satisfactorily addressed the criticisms or defects in

the quality control system of the firm identified in the final inspection report and, if not, why not." It is unclear whether the firm will be granted the opportunity to discuss the recommendation with the Director or supplement its previous submission with analysis or additional evidence when the Director indicates that the initial submission is not satisfactory. In the interest of due process, we recommend that the final rule give firms under review the opportunity for discussion and the submission of additional evidence under these circumstances.

Proposed Rule 4009(c)(3) contemplates that registered accounting firms may formally request Commission review of any determination by the Board that a firm submitted response to quality control defects identified in a particular inspection report does not satisfactorily address the criticisms or defects noted in that inspection report. It suggests, however, that the report will be made public 15 days after such request for review, unless otherwise directed by Commission order or rule. Given the potential impact of the information released, the Commission must have an appropriate length of time to consider the circumstances surrounding the noted disagreement. We respectfully encourage the Board to extend the period of consideration to 30 days in order to ensure adequate time for contemplation and response.

We also reiterate our comments on proposed Rule 1001 regarding our recommendation that the Board specifically distinguish those criticisms or defects that result from deficiencies in meeting firm standards, from criticisms or defects that result from deficiencies in meeting professional standards. This distinction is essential to ensure that firms are not dissuaded from setting firm standards that are higher than professional standards and requirements.

Proposed Rule 4009 is silent as to the Board's responsibility to perform a timely review of a firm's response to the quality control defects and its responsibility to maintain the confidentiality of inspection reports that are the subject of a response submitted within 12 months of the issuance of the related inspection report but on which the Board has not issued a determination. We recommend the Board adopt rules that such determination be completed within 30 days of the submission by the firm and explicitly state that no information will be released publicly prior to the time a determination has been reached and the period allowed for seeking Commission review has expired, so long as the response is submitted within the required 12 month period following issuance of the inspection report.

Proposed Rule 4010 – Board Public Reports

Proposed Rule 4010 contemplates the release of non-firm specific procedures, findings and results of inspections, with the identification of a firm or firms being permissible when their association with such information has previously been made public in accordance with Rule 4009, by the firm or firms involved, or by other lawful means. We re-

quest that the Board clarify what it contemplates would fall into the category of "other lawful means" in this context.

Impact on Foreign Firms

KPMG International and its non-US member firms encourage the Board to continue their dialogue with foreign regulators and to consider the specific issues faced by foreign firms. We look forward to commenting on future proposed rules that address foreign firms.

* * * * *

KPMG International is a Swiss non-operating association which functions as an umbrella organization to approximately 100 KPMG member firms in countries around the world, to whom it licenses the KPMG name. Each KPMG member firm is autonomous, with its own separate ownership and governance structure. The KPMG member firms do not share profits amongst themselves, and they are not subject to control by any other member firm or by KPMG International.

If you have questions regarding any of the information included in this letter, please call or write to Michael J. Baum, (212) 909-5604, mjbaum@kpmg.com.

Yours sincerely,

KPMG

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August 7, 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. 006
Proposed Rules on Inspections of Registered Public Accounting Firms

Dear Board Members and Staff:

In general I believe that the overall framework for conducting regular and special inspections is reasonable. However, I have concerns about the fairness of the proposed rules relating to the referral of findings on inspections to other authorities and the publication of reports concerning those findings. It is my view that the Board should be very tough on firms that do not comply with its rules. Simultaneously, the Board should be reluctant to make public any findings of weakness or defects in a firm's quality control system unless or until an actual violation of the Sarbanes-Oxley Act (the "Act"), rule of the Board, or any statute or rule administered by the Securities and Exchange Commission (the "Commission") has been determined.

Proposed Rule 4004

Proposed Rule 4004 states that if an inspection of a firm indicates that there may be a violation of the Act, rules of the Board, any statute or rule administered by the Commission, the firm's own quality control policies, or any professional standard, then the Board may: (a) report such violation(s) to the Commission and to state licensing agencies, and (b) commence an investigation or disciplinary proceeding.

I believe that this proposed rule does not provide adequate due process and could result in reporting matters to the Commission and to state licensing agencies that

may not be violations. The mere act of reporting such matters to the Commission and state licensing agencies could result in unfair repercussions for a firm or an individual before the fact of a violation has actually been determined. Therefore, I suggest that the Board revise this proposed rule to state that if an inspection of a firm indicates that there may be a violation of the Act, etceteras, it shall commence a more detailed examination, an informal inquiry, or a formal investigation if it determines that to be appropriate. Reporting suspected violations to other authorities and disciplinary proceedings should occur only after an investigation has determined that a violation has actually occurred.

Proposed Rule 4009

This proposed rule would allow a firm to submit evidence that it has improved its quality control systems and remedied defects in such systems no later than 12 months after the issuance of a final inspection report from the Board that contains criticisms of, or potential defects in, its quality control systems. Further, this proposed rule would permit the Board to make public the portions of an inspection report that a firm has not addressed to the Board's satisfaction.

I believe this rule is too lenient in allowing a full 12 months to respond. Even in the case of the very large firms, it should not take a full year for a firm to implement improvements to, and remedy defects in, its quality control systems. In addition, I believe the Board should conduct a more detailed examination, an informal inquiry, or a formal investigation if a firm fails to adequately address criticisms of, or potential defects in, its quality control systems.

If the Board conducts a more detailed examination, an informal inquiry, or a formal investigation of a firm and finds that a violation of the Act, rule of the Board, or any statute or rule administered by the Commission has occurred, then that information should be made public and referred to the Commission.

Thank you for the opportunity to comment. The above comments are the views of the author and not necessarily those of the partners of Most Horowitz & Company, LLP.

Sincerely,

s Robert J. Sonnelitter, Jr.
Robert J. Sonnelitter, Jr., CPA
Director of Quality Control
Most Horowitz & Company, LLP

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August 18, 2003

Chris Mandaleris, Deputy Director Inspections
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VIA E-mail to Comments@pcaobus.org

Re: PCAOB Rulemaking Docket Matter No. 006
PCAOB Release No. 2003-013, July 28, 2003
(Proposed Rules on Inspections of Registered Public Accounting Firms)

To the PCAOB:

We appreciate the opportunity to offer comment to the Public Company Accounting Oversight Board (the "Board" or the "PCAOB") on its proposed rules on inspections of registered public accounting firms. The Board is considering the proposed rules for adoption and submission to the Securities and Exchange Commission (the "Commission" or the "SEC") pursuant to the Sarbanes-Oxley Act of 2002 (the "Act").

The National Association of State Boards of Accountancy (NASBA) is the national organization of the accountancy regulators of all states and other U.S. jurisdictions (collectively, the "states"). NASBA's member boards (the "State Boards") are government agencies composed of both licensees and non-licensee public members. As the only authorities empowered to grant or revoke licenses of certified public accountants (CPAs), the State Boards understand the delicate balance between the need for swift discipline and the necessity of procedural fairness.

NASBA's ongoing primary focus is upon rules and policies relating to enforcement (including the collection of information that will facilitate enforcement in appropriate cases), with special attention to fostering federal/state cooperation. We believe that close cooperation and a working partnership of the PCAOB and the SEC with NASBA and the State Boards will result in more effective regulatory efforts than otherwise would be achieved. We are pleased that the Commission Order approving PCAOB rules for a registration system encouraged "continued close cooperation" between the PCAOB and state regulatory bodies.

I. General Comments.

In general, NASBA urges that these and other new regulations promote vertical clarity so that State Boards can easily translate PCAOB and SEC case results into swift, equitable and defensible disciplinary actions against licensed audit firms and individual licensees (or unlicensed firms or

accountants for whom a license is required) implicated in violations. In so doing, the PCAOB and the SEC will be able to place greater practical reliance upon an effectively administered State Board licensing and discipline function that puts offending licensees at risk of losing not just their SEC clients but their certificates and their livelihoods as CPAs.

We are pleased with provisions in the proposed rules for cooperation of the PCAOB with the State Boards by providing information from inspections as contemplated by the Act. However, as noted in our specific comments below, we do view with some concern the implications of some provisions that suggest possible PCAOB limitation on the flow of information to State Boards that may be useful for their enforcement activities. We urge, and trust, that the exercise of such limitations by the PCAOB will be restrained and that the PCAOB generally will forward information in a spirit of mutual cooperation between the PCAOB and the State Boards.

II. Comments on Selected Provisions of the Proposed Rules.

Proposed Rule 4004. Procedure Regarding Possible Violations.

Proposed Rule 4004 provides if the PCAOB determines that information obtained during an inspection indicates that the firm, an associated person or any other person may have engaged or be engaged in a violation (as described), the PCAOB shall "if it determines appropriate" report information concerning such possible violation to the Commission and "each state, agency, board, or other authority that has issued a license or certification number to the firm or person . . . authorizing such firm or person to engage in the business of auditing or accounting." We suggest that the rule also *expressly* refer to the reporting of such information: ", if known by the Board, to each state, agency, board, or other authority from which such a license or certification number is required for the activities of the firm or person even if such license or certification number is not obtained by the firm or person or such number otherwise is not known by the Board." We believe it appropriate that the PCAOB report information to each applicable licensing authority when the PCAOB becomes aware of activities by an unlicensed firm or person for which license is required by the applicable state (or possibly may be required, if there is doubt).

As noted in prior comment, to strengthen NASBA/State Board coordination with PCAOB/SEC oversight of registered public accounting firms and associated persons, we believe it is very important to recognize the significance of licensing by the State Boards. Firms and individuals engaged in the unlicensed practice of forms of public accountancy for which a license is required by the applicable state (typically including audits and reviews) are in violation of state law. State Boards generally have the statutory authority to initiate civil actions for injunctions as well as criminal prosecutions against such firms and individuals. We believe that oversight by the PCAOB should include vigilance to avoid fostering, even indirectly, condoning or tolerating the unlicensed practice of forms of public accountancy for which license or certification is required by applicable state law for *either* firms *or* individuals.

Also, we note that under the proposed rule the PCAOB is to report information to the Commission and the licensing authorities "if it determines appropriate." We believe that in almost every instance such reporting would be appropriate and trust that the PCAOB generally will forward information in a spirit of mutual cooperation between the PCAOB and the State Boards. We would therefore urge that PCAOB reporting to State Boards would be routine "unless it determines such report to be inappropriate."

Proposed Rule 4008. Transmittal of Final Inspection Report.

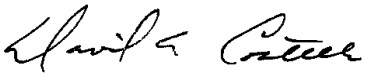
Proposed Rule 4008 provides that the PCAOB shall transmit a copy of the final inspection report to the firm, to the Commission, and "in appropriate detail, to each state, agency, board, or other authority that has issued a license or certification number authorizing the firm to engage in the business of auditing or accounting." It further provides that in the case of reports transmitted to

licensing authorities, the PCAOB "may omit from the report any information the disclosure of which could interfere with any investigation, prosecution, or disciplinary proceeding."

We believe that in almost every instance reporting to licensing authorities in complete detail and without omission would be appropriate. When the PCAOB has concern about the possible effect of information in an inspection report on an investigation, prosecution, or disciplinary proceeding, the first step – before omitting information from an inspection report – should be discussions between representatives of the PCAOB and the applicable State Boards to explore alternative solutions, with a view to keeping information omissions, if any, at the minimum possible. We note that any limitation on the flow of information to State Boards may impact their enforcement effectiveness and thus their protection of the public interest. Again, we urge, and trust, that the PCAOB generally will forward complete information in a spirit of mutual cooperation between the PCAOB and the State Boards.

Conclusion. NASBA appreciates the opportunity to provide these comments. Should you have questions about our thoughts on the proposed rules or other matters, please contact us. We look forward to ongoing communication and cooperation with the PCAOB and the SEC.

Sincerely,



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Chair, NASBA

PRICEWATERHOUSECOOPERS

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August 18, 2003

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

Subject: PCAOB Rulemaking Docket Matter No. 006, Comment Letter from PricewaterhouseCoopers LLP on Proposed Rules Relating to Inspections

Dear Mr. Secretary:

We appreciate this opportunity to provide our views on the proposed rules relating to inspections.

We fully support the PCAOB's (the Board's) mission to serve the public interest and rebuild public trust of the accounting and auditing profession, and we pledge our full cooperation with the Board and its staff to that end. In the inspection area, in particular, we believe that our relationship must be based on this shared purpose – and that an environment of mutual trust and respect is crucial to its achievement.

The press release that accompanied the proposed inspection rules characterized the proposal as a "general procedural framework for a program of inspections." That characterization ties into our primary comment on the proposal, which is that the proposed rules are overly general and non-specific, leaving many questions unasked and unanswered and promoting an environment of uncertainty that could impede progress toward our shared goals.

A good understanding of what to expect in terms of the breadth and depth of the inspection procedures and the standards to which an engagement team will be held is critical. Without this understanding, the "human nature" response to the uncertainties involved is to be overly cautious and tentative. For example, there are no specifics around either the nature of the actual testing programs to be undertaken or any standards or thresholds that would be employed to determine which findings might rise to a level requiring them to be reported and/or referred to other regulatory bodies. In addition, we believe that a better understanding is important in the context of establishing expectations of investors and other interested parties.

PRICEWATERHOUSECOOPERS

With respect to item 7 in the overview of the proposed rules, please know that we strongly support the Board's ongoing dialogue with its foreign counterparts and, of course, we have a keen interest in the "Special Issues Relating to Non-U.S. Firms" which are "open" while that dialogue continues.

Other comments and suggestions about specific proposed rules follow.

Rule 4000 We note that this rule provides for persons beyond the Board's staff to be involved in the inspection process. The wording here is quite broad, and it is unclear to whom it is intended to extend. We recommend that the rules explicitly provide that any consultants, sub-contractors or others involved in the inspections would be subject to the PCAOB's code of conduct and bound by the same confidentiality protocols as the Board and staff.

Rule 4002 It is not clear to us whether a single Board member can authorize a "special inspection" or whether the formal approval of the entire Board would be required. We believe that approval by the entire Board is important, and also recommend that the final rules describe the process the Board intends to undertake in seeking such authorization.

Rule 4003 We believe it is likely that "traditional" peer reviews will need to continue indefinitely to satisfy state licensing and other regulatory requirements. We look forward to working with the Board and others to identify ways in which we can capture efficiencies from the peer review process and the Board's inspection process. With that in mind, we recommend that the frequency of PCAOB inspections, as well as their timing within the year, be aligned with the peer review process in a manner that optimally supports the public interest goals of all licensing and regulatory authorities.

Rule 4004 With regard to the note added at the end of this proposed rule, we recommend that the wording be amended to convey a sense of the other entities to which the Board may make information available. In addition, given the clear intent of Congress around confidentiality, it should be explicitly provided that all recipients of documents and information protected under section 105(b)(5)(A) of the Act are subject to the confidentiality provisions of the Act.

Rule 4006 The proposed rules do not address issues around access to and the confidential treatment of non-issuer information that might be requested in connection with the Board's involvement with our internal quality inspection program or that may otherwise come up in the course of the Board's inspections. We believe it is critical that these issues be addressed so that the rules can be scoped to apply only to issuer data or that protocols can be established that appropriately reflect our professional, ethical and legal obligations to our non-issuer clients.

We also recommend that Rule 4006 cover record retention policies for copies obtained, notes taken and other documentation created in the course of the Board's inspections.

PRICEWATERHOUSECOOPERS

Rules 4007-4008-4009 We recommend that the proposed rules be amended to extend the "due process" around reporting through to the Board's final report, our response thereto and "any additional letter of comments" that may accompany the report. In addition, there is currently no provision for a firm to respond to, and no "due process" around, any potential disagreement about whether a firm has adequately remediated defects in its quality control system within the required twelve-month period. Our only interest here is the accuracy of these reports, and we believe that a comprehensive "due process" that builds in the final reviews necessary to ensure that the Board's reports are accurate and that our responses are faithful to the Board's final report, not a prior draft, is essential to serving the public interest.

Rule 4009 Building on other comments and suggestions set forth above, we note that the proposed rules do not articulate a concept or framework for how to determine whether or not a finding is related to the firm's quality control system. We believe that a broad definition is appropriate here because, quite simply, we cannot think of a finding that would not be tied in some way to our system of quality controls.

We also recommend that Rule 4009 make clear the Board's expectations around the types and nature of evidence required to demonstrate that the systems have been improved and defects remediated.

Rule 4010 In addition to not mentioning a specific firm by name, we recommend that this rule explicitly address the need to ensure that these reports do not inadvertently identify a firm indirectly. We also suggest that the rules clearly set out that best practices and positive trends – not just criticisms and defects – will also be communicated.

* * * * *

Finally, given the volume of rule proposals being put forth at this time, and in light of the fact that the Board's inspection process is sure to evolve as the Board learns from its experiences in executing it, we believe that it would be in the best interests of all involved that a provision for a "sunset review" (or some other means) be built into the inspections rules, enabling the Board to easily amend the rules as issues that will need to be addressed emerge.

Thank you for this opportunity to provide our views. Should you have any questions about anything in this letter, please call John Gribble at 973-236-7215.

Very truly yours,

PricewaterhouseCoopers LLP

Swiss Institute of Certified Accountants and Tax Consultants

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Location/Date Zurich, August 18, 2003

Recipient Secretary, Public Company Accounting Oversight Board

Sender Andreas Müller, Chairman, Walter Hess, General Secretary

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Subject **PCAOB Rulemaking Docket Matter No. 006**
PCAOB Rulemaking Docket Matter No. 007

General comments regarding PCAOB Release No. 2003-012: Proposed Rules 5000 through 5501, and PCAOB Release No. 2003-013: Proposed Rules 4000 through 4010

Also by e-mail comments@pcaobus.org
PCAOB
Office of the Secretary
1666 K Street, N.W.
Washington, D.C. 20006-2803
U.S.A.

Dear Mr. Secretary,

The Swiss Institute of Certified Accountants and Tax Consultants (the "Institute") appreciates the opportunity to submit our general comments on the Proposed Rules, *Proposed Rules on Investigations and Adjudications* (PCAOB Rulemaking Docket Matter No. 005, "Proposed Rules 005") and *Proposed Rules on Inspections of Registered Public Accounting Firms* (PCAOB Rulemaking Docket Matter No. 006, "Proposed Rules 006", collectively the "Proposed Rules 005 and 006") of the Public Company Accounting Oversight Board (the "PCAOB" or the "Board"), by which it implements Section 102, 104 (a) and 105 of the Sarbanes-Oxley Act of 2002 (the "Act").

In two previous letters to the PCAOB and the SEC dated March 27, 2003 (our "March Letter") and July 2, 2003 (the "July Letter"), we have provided comments as to how the Act and the proposed Registration System for Public Accounting Firms will affect our members. We refer to the March Letter and the July Letter and consider integral parts of this submission, as many of our comments made therein apply to the Board's Proposed Rules 005 and 006 as well. We attach the March Letter and the July Letter for your convenience.

We acknowledge and appreciate, that in both the Proposed Rules 005 and 006 the PCAOB has expressly acknowledged the "Special Issues Relating to Non-U.S. Firms", in particular that:

- "the nature and scope of the Board's oversight over non-U.S. accounting firms that audit the financial statements of U.S. public companies will be the subject of dialogue between the Board and its foreign counterparts";

- "the Board is committed to finding ways of accomplishing the goals of the Act without subjecting non-U.S. firms to unnecessary burdens or conflicting requirements"; and

- "the Board's Proposed Rules are not intended in any way to signal that the Board has already determined how its oversight should operate as to those firms".

In the context of the above-mentioned points, we would like to re-emphasize the following points from the Swiss perspective:

We have the same intention and are striving for the same goal as the PCAOB, namely "to protect the interests of investors and further the public interest through the preparation of informative, accurate, and independent audit reports for companies the securities of which are sold to, and held by and for, public investors" (Sec. 101(a) of the Act).

Nevertheless, the Board's Rules regarding registration adopted by the SEC as well as to the continuing inspection, investigation, and sanctioning powers of the Board set forth in the Proposed Rules 005 and 006, would create serious conflicts with Swiss law. We certainly welcome the PCAOB's stated intention of opening a dialogue with its foreign counterparts regarding the implementation of the Act and the adoption of appropriately modified rules in lieu of the Proposed Rules 005 and 006 regarding inspections and disciplinary procedures in foreign jurisdictions. However, we would like to mention that we have significant doubts as to whether such dialogue can be carried through and that an effective solution can be found between the PCAOB and the respective Swiss organizations within the Board's intended timeframe.

It follows that we recommend the timeframe for implementing these Proposed Rules be extended by at least one year (*i.e.*, until April 2005) for Swiss public accounting firms (and any other non-U.S firms). This additional time would allow the Swiss legislature (and the legislature of any other jurisdiction in a comparable situation) to put in place the envisaged legal framework as well as give the Swiss government an opportunity to implement a Swiss public accounting oversight system on a practical level. Furthermore, this additional time would enable the PCAOB to establish the means and processes of cooperation with the Swiss oversight body and to secure compliance with the spirit and intent of the Act by building on compliance with, and local enforcement through, the corresponding Swiss oversight system, and not by unilaterally imposing a duplicative and potentially conflicting oversight system. Any other approach would lead to unnecessary complication and inefficiency in the effort to reach the abovementioned goal, not only on the part of our members, but also for the PCAOB and the Swiss government.

With a Swiss accounting oversight system in effect, it is our position that the Board should neither directly inspect nor sanction Swiss public accounting firms. Rather, the Board should exercise its powers through, and in cooperation with, the Swiss accounting oversight body within the framework of a protocol to be established. Such indirect oversight would sufficiently protect the interests of investors and the public once the Board have familiarized themselves with the Swiss accounting oversight system and has found a common ground for a cooperative, bilateral oversight system rather than two unilateral, duplicative and (potentially) conflicting oversight systems.

We appreciate the opportunity to express our concerns that the Proposed Rules 005 and 006 should not set the benchmark for inspections, investigations and adjudications regarding public accounting firms established in Switzerland (and other non-US jurisdictions), but that implementation of the Act regarding those public accounting firms should follow different principles as set forth above and in our March Letter and July Letter. We look forward to continuing this discussion until a solution has been found that achieves our common cause, while fairly balancing the sometimes conflicting interests of the parties involved.

Respectfully submitted,

Swiss Institute of Certified Accountants and Tax Consultants

Andreas Müller
Chairman

Walter Hess
General Secretary

Attachment: Letter of the Institute to the PCAOB dated March 27, 2003
Letter of the Institute to the SEC dated July 2, 2003

Swiss Institute of Certified Accountants and Tax Consultants

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Location/Date Zurich, 27th March 2003 (Oer)

Recipient Office of the secretary, PCAOB

Sender Andreas Müller, Chairman, Walter Hess, General Secretary

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Subject **PCAOB Rulemaking Docket Matter No. 001**

Comments to proposed Rules 1000, 1001, 2100 through 2105, 2300, and Form 1

PCAOB
Office of the Secretary
Attn. Mr. Gordon Seymor, Acting General Counsel
Attn. Mr. Stanley Macel III, Senior Counsel Office of International Affairs
1666 K Street, N.W.
Washington, D.C. 20006-2803
U.S.A

We refer to the PCAOB Release No. 2003-1 dated March 7, 2003 that has been proposed by the Public Company Accounting Oversight Board ("PCAOB" the or your "Board") on March 4, 2003 with regard to its plan for a registration system for public accounting firms under the Sarbanes Oxley Act of 2002 (the "Act"). Therein you invite interested parties to submit comments in writing to the proposed PCAOB Rules 1000, 1001, 2100 through 2105 and 2300 (the "Rules") and the PCAOB Form 1 (the "Form"). In addition, you invite our comments to a series of questions relating to the registration of foreign public accounting firms (the "Questions").

We appreciate the opportunity to comment on the Rules and the Form and respond to the Questions on behalf of the Swiss Institute of Certified Accountants and Tax Consultants (the "Institute"), the organization, among others, of the Swiss accounting industry. The membership of the Institute comprises approx. 900 corporations and 4,500 individuals of various business sizes.

Of our members, the accounting firms referred to as the "Big Four" and a series of others will be affected by the Act. In their role as foreign public accounting firms issuing audit reports for issuers, or as accounting firms that play a substantial role in the preparation or furnishing of audit reports, they would be required to register under the Act, or as associated persons of a public accounting firm, they would have to give the required consents (all terms used in these comments and defined in the Act or the Rules are used with the meaning as so defined).

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I. Shared spirit and intentions

Our Institute fully supports the spirit and intentions that underlay the Act. In fact our Institute has been instrumental in implementing a system of auditor independence and quality control in Switzerland that is similar to the one to be instituted under the Act, and is presently actively engaged in consultations with the Swiss Federal Government regarding the current efforts to put in place a Swiss accounting oversight legislation. Our Institute is doing this with the goal to assure adherence by Swiss accounting firms to auditing standards regarding methodology, quality, ethical standards, personal and institutional independence, and compliance with all applicable laws in a way that is coherent with and equivalent to the standards and goals pursued by your Board and the Commission under the Act.

While we support in principle registration under and adherence to the Act by our members, we can only recommend that they do so if the Act is being implemented with regard to them in a way that allows them to continue to respect the laws of Switzerland. Otherwise , they would be exposed to conflicts and deadlocks that are not warranted by the spirit and intentions of the Act.

II. Conflicts between the obligations imposed bythe Act and Swiss law

Unless the necessary exemptions are granted, the obligations imposed by the Act, as implemented by the Rules and the Form on foreign public accounting firms will potentially cause serious, without such exemptions irresolvable conflic ts with Swiss law, in particular and without limitation regarding the following provisions (unofficial English translations attached for your convenience):

(1) Violation of secrecy obligations

(a) Swiss Penal Code ("SPC") Article 321: Violation of Professional Secrecy

Article 321 SPC protects information that accountants have acquired when acting under the secrecy obligation of Article 730 Swiss Code of Obligations ("SCO"). The criminal and penal secrecy obligation covers any information gathered in an auditing and assurance function with regard to an audited client and any third parties. Thus to allow disclosure of audit work papers and other related information to the Board or the Commission or any other third party, the consent of the audited company, and also of any third parties affected would be required insofar as secrets of such third parties are concerned. In practice, it would appear highly unlikely that such third party consents could be obtained.

(b) SPC Article 162 Violation of Production and Business Secrets

Article 162 covers information gained by an accounting firm in the course of assignments other than and outside of its audit assignment. The same principles and concerns apply as regarding SPC Article 321 (*cf.* section II(1)(a) above).

(c) Banking Act ("BA") Article 47: Banking Secrecy, and Federal Act on Stock Exchanges and Securities Trading ("SESTA") Article 43: Professional Secrecy Obligations of Securities Traders

The Articles of the BA and the SESTA protect the relationship between a bank or securities trader and its clients. As such, the Articles of the BA and the SESTA protect the related confidentiality interests of the audited banks that are issuers, and of their clients.

Again, in order to permit access and disclosure of work papers and information to the Board and the Commission, consent of the audited issuer bank and of any third parties affected would be required.

(2) Violation of public interest laws

(a) SPC Article 273 Economic Espionage

Article 273 SPC renders it an offense to make a production or business secret accessible to a foreign organization. It protects all of the elements of Swiss economic life for which there is an interest of non-disclosure to foreign public officials or private organizations.

Para. 1 of Article 273 SPC would apply to and penalize any investigative activity conducted by agents of your Board, the Commission and any other foreign authority within Switzerland as well as to any person facilitating access to such secrets.

(b) SPC Article 271 Illegal Acts in Favor of a Foreign State

A Swiss accounting firm that permits an inspection or investigation of its files in Switzerland by representatives of the Board, the Commission, or any other foreign public authority, or collects information from third parties in Switzerland and sends this information to a non-Swiss auditing firm in order for this information to be made accessible to the Board, may be found guilty of violation of Article 271 SPC.

We have to assume that activities conducted by your Board and its agents, or by a Swiss public accounting firm in assisting such activities, would be considered to fall under this provision, because the qualification of the Board as a private entity pursuant to Sec. 102(b) of the Act would not change the inherent public nature of its activities.

(c) Data Protection Act ("DPA")

Personal data may not be transferred to the Board (without the explicit consent of the persons concerned) since it declares in advance that it will not treat the data confidentially (*cf.* Section 105(b)(5)(B) of the Act). For personal, highly sensitive data, as would be required in answering Part V of the Form (see section IV (5) To Part V below), consent of the persons concerned would be required in any circumstance. While we expect that consent of the audit client can be obtained, audit work papers may contain personal data of third parties whose consent may practically not be obtainable.

(3) Conclusion regarding conflicts with Swiss law

Although we are not in a position to give a final interpretation of Articles 271 and 273 SPC as they relate to disclosure of and granting access to work papers or other information in favor of the Board or rendering testimony before the Board, we could not recommend to our members to subject themselves unconditionally to the Act without these issues being clarified.

In addition, distinguishing between information and documents which would require third party consents for production to your Board and information and documents that would not, may be difficult, and it is unlikely that such third party consents could be obtained where necessary.

In our opinion, any Swiss public accounting firm that subjects itself to the inspection and investigation powers of the Board runs into a direct conflict with Swiss law and as a result exposes itself to criminal penalties and civil actions for damages that could put its very existence in peril.

This conflict is a matter of great concern to the entire accounting industry in Switzerland as well as to the Swiss Governmental Authorities. We trust that the Board and the Commission understands these concerns and will work with the Swiss Government and the Swiss accounting industry to find ways and means to implement the spirit and intentions of the Act while removing or minimizing the effects of any potential conflict with Swiss law.

III. Swiss legislation regarding accounting standards

(a) Present Swiss legislation

(i) Listing Rules of SWX Swiss Exchange

Issuers registered with SWX Swiss Exchange must appoint accounting firms registered with the SWX, whereby registration is granted upon request and is conditioned upon the respective accounting firm's agreement to become subject to the sanctioning rules and powers of the SWX. For violations of duties under the listing rules, sanctions can be imposed on the

auditors, *e.g.* reprimanding, replacement of the responsible accountant, imposing a fine, revocation of registration, publication of the violation and the sanctions imposed. Most Swiss issuers registered with the SEC have a primary listing with the SWX, and as such the oversight of the SWX applies to practically all of the Swiss accounting firms auditing issuers.

(ii) Swiss Statute on Banks and Savings Institutions

Audits of banks and savings institutions licensed to do business in Switzerland must be carried out by authorized bank auditors. The Swiss Federal Banking Commission ("SFBC") grants these authorizations and exercises an oversight over authorized bank auditors. Authorization to audit banks in Switzerland is granted by the SFBC if the auditors meet several conditions regarding, *e.g.*, adequate organization, reputation of management and auditors in charge, independence from the audited banks and the banking business in general. Most of the accounting firms auditing issuers registered with the SEC or Swiss subsidiaries of issuers in Switzerland are also registered bank auditors, so that this oversight by the SFBC over authorized bank auditors assures adherence to the respective standards over practically all of the Swiss public accounting firms affected by and subject to the registration and consent requirements of the Act.

(b) Envisaged Swiss legislation

Talks are under way between representatives of the private sector and the Swiss Government regarding a Swiss public accounting oversight system, involving legislation as basis for a Swiss accounting oversight board (the "Swiss PCAOB") and a mechanism that assures the application of a set of accounting standards regarding, *e.g.*, quality, ethical standards and independence. It is too early to set forth any details of the envisaged legislation and the position, duties and powers of the Swiss PCAOB within the envisaged accounting oversight system.

In these discussions, our Institute is guided by the following ideas:

(i) The Swiss public accounting oversight system will be aimed at assuring standards and principles for the Swiss accounting industry that are similar, in many ways identical, and in all instances at least equivalent to those of the Act;

(ii) the Swiss PCAOB will be independent of the accounting industry;

(iii) the Swiss PCAOB will have duties and powers necessary and appropriate to implement and enforce the standards and principles of the respective Swiss legislation; and

(iv) one of the tasks of the Swiss PCAOB will be to act as the counterpart of your Board and the Commission in an ongoing dialogue and interplay.

The details of all of this would need to be worked out.

Without giving due consideration to the equivalence of U.S. and Swiss legislations and to the necessity of a dialogue and interplay between oversight authorities, however, we believe that Swiss applicants would face a system of double oversight that would very likely result in conflicting requirements for and double jeopardy to them to the detriment of the Swiss accounting industry and the Swiss issuers, and without any benefit to the U.S. securities market.

IV. Response to Questions raised in Release No. 2003-1 Part B.2

Q1: *Is it feasible for foreign public accounting firms to register within 180 days of the date of the Commission's determination that the Board is capable of operating?*

Compiling the information and documentation necessary for registration within the timeline set forth by your Board is not in itself impossible, with the exceptions and exemptions discussed below where compilation and delivery would be impossible, and our members are committed to devote the necessary attention and resources to this task. For the reasons set forth in section II above, however, it would be impossible for our members to subject themselves unconditionally to the inspection and investigation (testimony and document production) power of the Board over registered public accounting firms pursuant to Sec. 104 and 105 of the Act without certain exemptions being granted pursuant to Sec. 106(c) of the Act. Such exemptions may be granted on a temporary and conditional basis, as more fully set forth in our response to Q6 below.

Should foreign public accounting firms be afforded some longer period (e.g., an additional 90 days) within which to register?

For the above reasons, we ask that the timeline for the registration, and in particular for (a) submitting the information and documentation, (b) submitting the consents required pursuant to Part VIII of the Form, and (c) submitting to and application of the investigation, inspection and disciplinary powers of the Board by and to Swiss applicants be extended by at least one more year. This extension would allow for the time necessary to work out an understanding between the Board, the Commission and the Swiss Government and the Swiss accounting industry regarding the scope and nature of the proposed exemptions and the complementary measures to be put in place in Switzerland, and would give the necessary time to the Board and the Commission to grant and implement these exemptions and to the Swiss legislator to adopt the corresponding legislative measures.

The practical impact of such extension should not be too great, since no Swiss public accounting firm would audit more than 100 issuers, so that inspections can be expected to be conducted in a rhythm closer to three years than one year (*cf.* Section 104(b)(1)(B) of the Act).

The same extended timeline should apply for the consents by Swiss accounting firms that have to be provided by U.S. applicants as part of their own application for registration.

Q2: *Are there any portions of Form 1 that are inapplicable, or that should be modified, in the case of non-U.S. applicants?*

We will here comment on the Form, following the order of items in the Form. Further comments to the Form and the Rules are contained in section V below.

(1) To General Instructions, Item 5:

We refer to our separate comments in section V(6) regarding confidential treatment.

(2) To Part I, Item 1.6 (*Associated Entities* of Applicant):

This requirement should relate to entities associated otherwise than through the network of which the respective Swiss accounting firm is a party (that means for practically all Swiss Applicants associated entities in Switzerland only), in order to avoid double notifications.

(3) To Part II, Item 2.4 (Issuers for which Applicant *Played, or Expects to* Play, a *Substantial Role in* Audit):

This requirement should relate to issuers for which the applicant knows or has reason to believe that he plays a substantial role. An accounting firm may not in all circumstances know the share of its work in comparison to the overall audit work. Accordingly, the accounting firm that has primary responsibility for the audit should be responsible for notification and compliance with the Act and the Board's requirements. Further, the information should be treated confidentially.

(4) To Part III (Applicant Financial Information):

The demarcation line between items (b) through (e) is difficult to draw when using historic data that had not been gathered in light of these criteria, so some of our members may have to take recourse to estimates when it comes to allocating revenues to the different items of clause 3.1.

This type of information has never been made public, as all of our member firms concerned are private entities that are not required to release financial information. The information should be treated as confidential.

(5) To Part V (Proceedings involving the Applicant's Audit Practice):

Compiling this information and disclosing it to the Board poses an extraordinary burden on our members and may in some instances even be impossible.

Information of the type sought has not been centrally collected and kept by our members and is considered confidential by all of the accounting firm, its associated person or persons and the third party or parties affected. Also the fluctuation of personnel typical for our industry would require a search through archives of third-party firms or firms now defunct, what would practically not be possible to execute. Obtaining consent form third parties affected, which would be necessary for confidentiality and data protection purposes, might be difficult if not impossible to obtain. We also would like to draw your attention to the fact that this type of information has never been made public, and public disclosure of information of this type would be a novelty for Swiss businesses.

Public disclosure of this type of information would *de-fact* lead to a discrimination of Swiss registered accounting firms against other accounting firms in Switzerland not subject to the Act, and might also expose them to the risk of law suits (of an imitative or consequential nature) that otherwise would not have been brought against the respective Swiss firm.

Given the practical difficulty if not impossibility of gathering the information sought, the conflict with Swiss criminal provisions against economic espionage and acting in favor of a foreign state, and the potentially serious practical consequences for a Swiss public accounting firm that may audit only one or two issuers with a secondary listing in the U.S., we propose that disclosure under items 5.1 through 5.4 be limited to (i) procedures pending (as stated in section 102 (b) (2) (F) of the Act), and (ii) being in connection with issuers or the U.S. securities market in general, and in relation to such procedures limited to (iii) information and documents at hand with the respective applicant and their associated entities or persons associated with such public accounting firm, and (iv) information and data whose release would not require consent from third parties other than the associated entities of or persons associated with such public accounting firm or conflict with the Swiss criminal provisions referred to above except where information and documents can be submitted on a no-name basis.

The Swiss public accounting firms also would have to receive in advance assurance of confidential treatment of the respective information (see section V(5) To Rule 2300 (c) below).

The information should at any rate be treated as confidential.

(6) To Part VII, Item 7.2 (Listing of *Accountants* Associated with Non-U.S. Applicants):

We consider it incommensurate and not warranted by the spirit and intentions of the Act to disclose information on all persons associated with the public accounting firm, whether or not active on the audit engagement for any issuer.

We propose to restrict the list to:

(a) all partners of the public accounting firm who provide audit, review or attest services for any issuer;

(b) all persons which are members of the audit engagement team and provide more than ten hours of audit, review or attest services for any issuer p.a. (*cf*. Release No. 33-8183, SEC Final Rule Strengthening the Commission's Requirements Regarding Auditor Independence, Part II.A);

(c) but (b) not extending to persons engaged only in clerical and ministerial tasks (*cf.* Sec. 2(a)(9)(B) of the Act).

(7) To Part VIII, Item 8.1 (Consents to Cooperate with the *Board*):

As indicated above, the required consents and statements can only be provided once a common understanding of the scope and nature of the exemptions and the complementary measures to be put in place in Switzerland has been reached and these exemptions have been granted.

Q3: *In addition to the information required by Form 1, is there any additional information that should be sought from non-U.S. applicants?*

The Board should seek detailed information of the laws of such jurisdiction that could potentially conflict with the Act and its implementation as envisaged, of the accounting oversight system in the home country of the foreign public accounting firms, and of ways and means to collaborate with national oversight authorities and Governments in view of implementing the spirit and intentions of the Act without conflicts and deadlocks.

Q4: *Do any of the Board's registration requirements conflict with the laws of any jurisdiction in which foreign public accounting firms that will be required to register are located?*

Regarding the general conflicts of legal systems caused by the requirements of the Act, we refer to section II above.

As noted above, the consents required in Part VIII of the Form can only be provided and the powers of inspection and investigation of the Board can only be implemented once a common understanding of the scope and nature of the exemptions and the complementary measures to be put in place in Switzerland has been reached and these exemptions have been granted.

Q5: *In the case of non-U.S. firms that are required to register because they play a substantial role in the preparation or furnishing of an audit report on a U.S. issuer, is the definition of "substantial role" in Rule 1001(n) appropriate?*

In our view it is appropriate.

In particular, should the 20 percent tests for determining whether a foreign firm's services are material to the audit, or whether the foreign firm performs audit procedures with respect to a significant subsidiary, be changed? Would a 10 percent threshold more realistically capture firms that materially participate in the preparation or furnishing of an audit report?

No change should be made. The 20 percent test is realistic. We refer to our response to Q2 (3), To Part II, Item 2.4 of the Form (primary responsibility for the lead accounting firm to determine substantial role).

Q6: *Should the requirements to register be different for foreign public accounting firms that are "associated entities" (as defined in the Board's rules) of U.S. registered public accounting firms than for foreign firms that are not associated with U.S. registered firms?*

There should not be any differentiation. See our response to Q2 (2) To Part I, Item 1.6.

Q7: *Should registered foreign public accounting firms be subject to Board inspection?*

In our view, Swiss accounting firms, even if registered, should not be subject to the inspection and investigation powers of the Board, including the power to hear testimony, to request document production and to impose disciplinary sanctions. In particular the Board could not conduct any evaluation and testing or inspections in Switzerland through its agents and staff, and could not request any agent or other representative of a Swiss registered public accounting firm to appear before the Board to render testimony.

Could the Board, in some cases, rely on home-country regulation in lieu of inspection of foreign public accounting firms?

The Board could and should rely on Swiss actual and prospective legislation in lieu of direct inspection, investigation and sanctioning.

If so, under what circumstances could this occur?

We refer to section III above. In the period until the new Swiss accounting oversight legislation is put in place, this could be done on the basis of a temporary exemption and in reliance on the present Swiss legislation. Our Institute and, we trust, the competent bodies of the administration of the Swiss Government would be willing to share with you information on the methodology applied to assure professional standards regarding quality ethical standards, independence etc. of the Swiss accounting industry. Information concerning individual cases of misconduct could be shared on the basis of existing mechanism of information exchange (between SEC and SFCB in the banking sector, through judicial assistance mechanisms, etc.).

After the Swiss accounting oversight legislation has been put in place, your Board could do this on the basis of a partial exemption and in reliance on the accounting oversight system put in place by Swiss legislation.

Q8: *Aside from Board inspection, are there other requirements of the Act from which foreign public accounting firms should be exempted? If so, under what circumstances?*

In our opinion, the nature and scope of the exemptions that are necessary for Swiss registered public accounting firms can only be determined through a process of discussion between your Board, the Commission, the Swiss Governmental Authorities, and the Swiss accounting industry. At any rate the exemptions must be of a nature to take into consideration the legal conflicts and practical problems set forth in these comments.

Q9: *Are there requirements different from those the Act imposes on all registered public accounting firms that the Board should apply to foreign public accounting firms?*

We refer to our response to Q6 and Q8. The Board should not apply any other requirements to Swiss registered public accounting firms.

Q10: *Should the Board's oversight of foreign registered public accounting firms that are "associated entities" (as defined in the Board's rules) of U.S. registered public accounting firms be different than its oversight of foreign public accounting firms that are not associated entities of U.S. registered firms?*

In principle we refer to our response to Q6 above, but note that a non-U.S. accounting firm not associated or affiliated with a U.S. accounting firm is not subject to the provisions of the SEC Practice Section of the American Institute of Certified Public Accountants relating to international firms and international associations of firms, in particular AICPA SEC Practice Section Manual § 1000.08(n) regarding inspection procedures to be carried through by an expert in U.S. accounting, auditing, and independence requirements. The fact that such review is being conducted should facilitate the granting of an exemption from the inspection and investigation powers of the Board to the respective Swiss firms.

Should the U.S. registered firm have any responsibility for the foreign registered firm's compliance with the Board's rules and standards?

No, we refer to our response to Q2, item 2.4, Q5 and Q6 above.

V. Comments to Rules not addressed in section IV above.

(1) To Rule 1001 Item (a)(Accountant) (2) and (3)

In a Swiss, and continental-European, context, a reference to an undergraduate degree is not meaningful. We propose to refer to "higher professional or university degrees".

(2) To Rule 1001 Item (c)(Associated Entity)

See our comments at IV(2) above.

(3) To Rule 1001 Item (q)(Rules or Rule of the Board)

As a very limited number of Rules of the Board have been published so far, our comments may need to be modified or elaborated upon after publication of further Rules of the Board.

(4) To Rule 2001 (Application for Registration)

The Board should confirm receipt of the application immediately.

(5) To Rule 2005 Item (c)(Requests for More Information)

This Rule should only apply if the Board requests additional information because the application is deemed incomplete. If the application is complete in regard of the Rules and Form, a request for further information should not cause the date of submission of the application to be postponed or the application to be deemed not received.

(6) To Rule 2300 Item (c)(Confidential Treatment Request) and (d) (Application Procedures)

Certain types of information provided by Swiss Applicants should be granted confidential treatment on a global basis, given that certain information has not been made publicly available before and publication may trigger negative and harmful consequences for the applicant (see sections II, IV(4) and IV(5) above). There should be a procedure by which the applicant can receive a binding response on whether information of a certain type will be treated confidential or not before the applicant has submitted such information.

(7) To Rule 2300 Item (h)

Also the Commission should treat information as confidential that has been granted confidential treatment by the Board.

VI. Conclusions.

(1) Timeline

The timeline should be extended by at least one more year for the registration by Swiss public accounting firms.

(2) Exemptions

The Board, the Commission and the Swiss Governmental Authorities and the Swiss accounting industry, considering the complementary legislative measures to be put in place in Switzerland, should seek an understanding on the scope and nature of the exemptions to be granted to Swiss applicants from the requirements

(a) to furnish certain types of information otherwise required for registration that cannot be collected and provided by Swiss accounting firms for legal reasons, third party consent requirements or practical difficulties (see section IV Q2(5) To Part V above)

(b) to furnish the consents required under part VIII (see section N Q2 (1) to Part VIII above) of the Form, and

(c) to subject to the investigation (testimony, work paper production), inspection and disciplinary powers of the Board.

(3) Dialogue and interplay

Your Board, the Commission and the Swiss Governmental Authorities should establish an appropriate mechanism of dialogue and interplay between your Board and the envisaged Swiss PCAOB.

We appreciate the opportunity you offer for a discussion regarding the ways and means how to implement the Act, and we hope to be able to continue this discussion until a solution is being found that takes into consideration its different, at times even conflicting, aspects.

Yours sincerely

Swiss Institute of Certified Accountants and Tax Consultants

Andreas Müller
Chairman

Walter Hess
General Secretary

Enclosures

- mentioned

Unofficial translation of the provisions of Swiss law

referred to in the Comments by the Swiss Institute of Chartered Accountants and Tax Advisers, dated March 26, 2003

Swiss Code of Obligations (SCO)

Article 321a Employee's Duty of Care and Loyalty

1 The employee must carefully perform the work assigned to him, and loyally safeguard the employer's legitimate interests.
2 …
3…
4 In the course of an employment relationship, the employee shall not make use of or inform others of any facts to be kept secret, such as, in particular, manufacturing or business secrets that come to his knowledge while in the employer's service. Also, after termination of the employment relationship, he shall continue to be bound to secrecy to the extend required to safeguard the employer's legitimate interests.

Article 730 Violation of Professional Secrecy of Auditors

1 When reporting and giving information, the auditors shall safeguard the business secrets of the Company.

2 Auditors are prohibited from communicating to individual shareholders or third parties any observations they have made while carrying out their duties. The duty to inform a special auditor remains reserved.

Swiss Federal Act on Data Protection (DPA)

Article 6 Transborder data flows

1 No personal data may be transferred abroad if the personal privacy of the persons affected could be seriously endangered, and in particular in cases where there is a failure to provide protection equivalent to that provided under Swiss law.

2 Whoever wishes to transmit data abroad must notify the Federal Data Protection Commissioner beforehand in cases where:
a) there is no legal obligation to disclose the data and
b) the persons affected have no knowledge of the transmission.

3 The Federal Council shall regulate the notification procedure in detail. It may provide for a

simplified notification procedure or exemptions from the duty to notify in the event that the processing does not endanger the privacy of the persons affected.

Article 35 Breach of Professional Secrecy

1 Whoever willfully and without authorization discloses confidential and sensitive personal data or personal profiles that have come to his knowledge in the course of professional activities that require that he has knowledge of such data, shall be punishable on application for prosecution by a term of detention or by fine.

2 Whoever willfully and without authorization discloses confidential and sensitive personal data or personal profiles that have come to his knowledge in the course of his activities for persons who are subject to a duty of professional secrecy or in the course of his vocational training with such persons, shall also be punishable on application for prosecution by a term of detention or a fine.

3 The illegal communication of confidential and sensitive data or personal profiles shall also be punishable after the relevant person has ceased to practise his profession or has completed his vocational training.

Federal Law on Banks and Savings Banks (Banking Act, BA)

Art. 47

1 Whoever divulges a secret entrusted to him or of which he has become aware in his capacity as officer, employee, mandatory, liquidator or commissioner of a bank, as representative of the Banking Commission, officer or employee of a recognized auditing company and whoever tries to induce others to violate professional secrecy, shall be punished by imprisonment for not more than six months or by a fine of not more than SFr. 50,000.
2 If the act has been committed by negligence, the penalty shall be a fine not exceeding SFr. 30,000.
3 The violation of professional secrecy remains punishable even after termination of the official or employment relationship or the exercise of the profession.
4 Federal and Cantonal regulations concerning the obligation to testify and to furnish information to a government authority shall apply.

Federal Act on Stock Exchanges and Securities Trading (Stock Exchange Act, SESTA)

Art. 43 Breach of professional secrecy

1 Whosoever:

a. discloses a secret which has been confided to him in his capacity as a member of a governing body, employee, mandatary or liquidator of a stock exchange or a securities dealer, as a member of one of the governing bodies or employee of recognized auditors, or of which he has become aware in any such capacity; or

b. attempts such breach of professional secrecy by inducement,

shall be punished by imprisonment or with a fine;

2 Whosoever breaches professional secrecy after termination of office or his employment shall nevertheless remain liable to punishment.

3 The federal and cantonal provisions relating to the duty to testify and the duty to provide information to the authorities remain reserved.

Swiss Criminal Code (Swiss Penal Code, SPC)

Article 162 Violation of manufacturing or business secrets

Whoever reveals a manufacturing or business secret which he is obliged to keep by legal or contractual obligations,
whoever uses such revelation for the benefit of himself or another person,
shall be, upon request for prosecution, sentenced to imprisonment or fined.

Article 271 Prohibited Activities for a Foreign State

1. Whoever conducts, without authorization, for a foreign State on Swiss territory acts that are within the competence of public authorities or public officials,
whoever conducts such acts for a foreign party or another foreign organization,
any person aiding in such acts,
shall be sentenced to imprisonment, in severe cases to penal servitude.

2. .....

3. .....

Article 273 Economic Intelligence Service

Whoever searches out manufacture or business secrets in order to make them accessible to a foreign official public body, foreign organization, to a foreign private company or their agents, shall be sentenced to imprisonment or, in severe cases, penal servitude. In addition, a fine may be imposed.

Article 321 Violation of Professional Secrets

1. Clergymen, barristers, defense counsels, notaries, examiners being sworn to secrecy, doctors, chemists, midwifes, and their assistants who reveal a secret which they were told or of which they took knowledge while exercising their profession, shall be, upon request for prosecution, sentenced to imprisonment or fined.
The same goes for students, revealing a secret of which they took knowledge during their studies.
Violations of professional secrets are punishable after the end of the studies or professional activities as well.

2. The offender remains exempt from punishment if the secret has been revealed because of the consent of the party entitled or following the written permission of the competent or supervising authority, issued on the offender's request.

Swiss Institute of Certified Accountants and Tax Consultants

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Location/Date Zurich, July 2, 2003

Recipient Secretary, Securities and Exchange Commission

Sender Andreas Müller, Chairman, Walter Hess, General Secretary

---

Subject **PCAOB-2003-03**

Registration System for Public Accounting Firms
Comments to PCAOB Release No. 2003-007: proposed Rules 1001, 2100 through 2106, 2300, and Form 1

Securities and Exchange Commission
Secretary
Attn. Mr. Jonathan G. Katz
450 Fifth Street, N.W.
Washington, D.C. 20549-0609
U.S.A

PCAOB Release No. 2003-007: Registration System for Public Accounting Firms

Dear Mr. Katz:

The Swiss Institute of Certified Accountants and Tax Consultants (the "Institute") appreciates the opportunity to submit comments on the proposal of the Public Company Accounting Oversight Board (the "PCAOB" or the "Board") implementing the accounting firm registration requirements of the Sarbanes-Oxley Act ("the Act"). Our comments refer to the PCAOB Release No. 2003-7, comprising the proposed PCAOB Rules 1001, 2100 through 2106, and 2300 (the "Rules"), and the PCAOB Form 1 (the "Form"), which was submitted to the Securities and Exchange Commission (the "SEC" or "your Commission") on May 8, 2003, and to which your Commission has issued Release No. 34-47990, File No. PCAOB-2003-03, published in the Federal Register of June 11, 2003. Therein you invite interested parties to submit comments in writing to the Rules and the Form.

The Institute is the professional body representing, among others, the Swiss accounting profession. In our letter of March 27, 2003 to the PCAOB (our "March Letter"), we stated our position and provided comments on how the Act, Rules, and Form (in the version of March 7, 2003) will affect our members. We attach the March Letter for your convenience and consider it to be an integral part of this submission. In the event of differences between the two, this letter takes precedence over our March Letter.

All terms used in these comments and defined in the Act, the Rules, or our March Letter are used with the meaning as so defined, except if defined differently herein.

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I. Shared Spirit and Local Actions

(1) Shared Spirit in the U.S., Switzerland, and other Jurisdictions

Our Institute continues to fully support the spirit and intentions that underlie the Act. Our Institute also feels, and countless talks to colleagues, industry organizations, and governmental entities within and outside of our country have confirmed, that the same is true with regard to the countries of the EU and other jurisdictions. Our members are affected by the Act and its implementation in many ways similar to public accounting firms within the EU and other jurisdictions.

(2) Equal Treatment of non-U.S. Applicants

We appreciate your stated intention to treat all non-U.S. applicants who anticipate or experience difficulties in registering in accordance with the proposed rules or in subjecting themselves to the enforcement powers of the PCAOB in a uniform and equal way. We trust that this will continue to be the case, and that there will be no discrimination of non-U.S. applicants due to their nationality.

(3) Planned Legislation Regarding Swiss Oversight System

This position and general attitude of shared spirit and intent has guided not only our Institute vis-à-vis the SEC and the PCAOB regarding the steps and regulations proposed for implementing the Act, but also the Swiss government with regard to Swiss legislation. For details regarding the legislative process, we refer to the letter on behalf of the Swiss Authorities that this letter accompanies.

(4) Extension of Timetable for Registration

We strongly feel that registering with and subjecting ourselves to the inspection and disciplinary regime of the PCAOB within the currently proposed timeframe, while a Swiss oversight system is simultaneously being enacted and implemented, would expose our members to a practical burden and risks associated with conflicts of legal systems that are not warranted by the spirit and intent underlying the Act.

We also are of the strong opinion that it would be unfair and unjust to require Swiss applicants to register while so many issues regarding effects of registration remain open, given that “the nature of the oversight to be exercised over registered foreign public accounting firms is a matter the Board has yet to resolve”. Rather registration should only occur once the scope and nature of the investigative and disciplinary powers of the Board have been determined conclusively or at least to a degree that gives the certainty necessary for Swiss applicants to conduct their business.

We thus emphatically request that the registration process for Swiss applicants (and any other non-U.S. applicants in jurisdictions where a local public accounting oversight system is being put in place) be delayed by another period of 360 days and that the effective date for the inspection and disciplinary powers of the Board be postponed by an addition period of 360 days. This would allow the Swiss legislature (and the legislature of any other jurisdiction in a comparable situation) to put in place the envisaged legal framework, and the Swiss government to implement the Swiss public accounting oversight system on a practical level. It would also enable the PCAOB and your Commission to establish the means and processes of cooperation with the Swiss oversight body and to secure compliance with the spirit and intent of the Act by building on compliance with and local enforcement through the corresponding Swiss oversight system (PCAOB Release No. 2003-007, Part B.3, page 20), not by unilaterally imposing a duplicative and potentially conflicting oversight system. Any other approach would lead to a waste of time and efforts both on the side of our members and on the side of the PCAOB, your Commission, and the Swiss government.

This time and these efforts should indeed be spared and saved for what is our common goal and intention, namely "to protect the interests of investors and further the public interest through the preparation of informative, accurate, and independent audit reports for companies the securities of which are sold to, and held by and for, public investors" (Sec. 101(a) of the Act).

(5) Effects of Registration Limited to Contacts between Oversight Bodies

Once the Swiss accounting oversight system has come into effect, it is our position that the Board should neither directly inspect nor sanction Swiss public accounting firms. Rather the Board should exercise its powers through and in cooperation with the Swiss accounting oversight body within the framework of a protocol to be established. Such indirect oversight would sufficiently protect the interests of investors and the public once the Board and your Commission has familiarized themselves with the Swiss accounting oversight system and found a common ground for a cooperative, bilateral oversight system rather than two unilateral, duplicative, and (potentially) conflicting oversight systems.

II. Conflicts between Obligations Imposed by the Act and Swiss Law

We shall not reiterate the provisions of Swiss law that could be violated by implementation of the Rules and submission of the completed Form, nor shall we reference the individual clauses and provisions of the Rules and the Form that would cause these violations.

(1) Attenuation of Certain Conflicts with Swiss Law

We appreciate that the amendments applied by the Board to the Rules and the Form (version of March 7) have attenuated, if not removed, some of these conflicts. We will not comment on these modifications in detail.

(2) Reservation for Conflicting non-U.S. Laws

We also appreciate the opportunity offered by Rule 2105 to submit evidence of conflicting non-U.S. laws where the submission of information requested as part of the registration would cause the applicant to violate such non-U.S. law, including a copy of the relevant portion of the non-U.S. law and a legal opinion buttressing the position of the applicant. We will comment further on proposed Rule 2105 in Section III(3) below.

It is unfortunate, however, that this remedy has been limited to the submission of information as part of the registration process, whereas the consequences of registration, including but not limited to the continuing inspection, investigation, and sanctioning power of the Board, is prone to create conflicts with Swiss law that are at least as serious as those created by the registration process. We therefore repeat our proposal with all due emphasis that the remedy concerning conflicting non-U.S. law expressed in Rule 2105 be extended to all conflicts created or threatened by the implementation of the Act (cf. also Section V below.)

(3) No Third-Party Consents

We understand that public accounting firms shall obtain consent from the issuers whose audit is at stake, and from their associated persons insofar as necessary for compliance with the Act, the Rules, and the Form. Swiss applicants should not, however, be asked to obtain consents from third parties, in particular from contract partners of issuers insofar as such third parties have a *bona fide* confidentiality interest. Rather a global exemption should be granted covering such instances. Anything else would interfere with audit clients' business, distort competition, and create intolerable complications.

III. Comments on Certain Rules

The following comments are based on our current knowledge and understanding of the implications of the situation. Additional comments may come up at a later stage, in particular as a consequence of the evolving Swiss legislative process.

(1) To Rule 1001 Item (a)(iv)(Associated Entity)

We refer to our comment in the March letter to Rule 1001 Item (c) and repeat that this definition should exclude entities associated with the Swiss public accounting firm through the

network to which the respective Swiss accounting firm is a party. It should include only subsidiaries, the parent company, and sister companies of the Swiss public accounting firm within Switzerland (and, exceptionally, also abroad, in particular in the Principality of Liechtenstein), in order to avoid double notification and unwarranted administrative burdens.

Issues arising from the fact that the Principality of Liechtenstein is a jurisdiction separate and apart from Switzerland, but that several of our members audit clients or maintain subsidiaries or branch offices in Liechtenstein would have to be addressed separately.

(2) To Rule 1001 Item (p)(ii)(Play a Substantial Role in the Preparation or Furnishing of an Audit Report)

We refer to our comment in the March Letter to Rule 1001 Part II, Item 2.4 (Issuers for which Applicant *Played, or Expects to* Play, a *Substantial Role in* Audit). The accounting firm that has primary responsibility for the audit should have exclusive responsibility for notification and compliance with the Act and the Board's requirements regarding the "material service" test. Further, the information should be treated as confidential.

(3) To Rule 2105 (Conflicting Non-U.S. Laws)

While we in principle welcome the limitations regarding non-U.S. law offered by this Rule, we would like to point out that legal impediments arise not only from non-U.S. laws being violated as a consequence of the submission of the information requested (and in general of compliance with the Act), but also from laws where submission of information or compliance with the Act would expose the Applicant to negative consequences sufficiently severe to warrant an exemption and where necessary consents and waivers by third parties are not obtainable (*e.g.*, consents from customers of a Swiss audit client, *cf.* item II(3) above).

(4) To Rule 2106 Item (c)(Requests for More Information)

We refer to our comment in the March Letter to Rule 2005 Item (c). This Rule should only apply if the Board requests additional information because the application is deemed incomplete. If the application is complete insofar as the information requested in the Form has been submitted, the application should be deemed received irrespective of a subsequent request for additional information.

(5) To Rule 2300 Item (b)(Confidential Treatment Request) and (c) (Application Procedures)

Certain types of information provided by Swiss applicants should be granted confidential treatment on a global basis, given that certain information has not been made publicly available before and publication may trigger harmful and unforeseeable consequences for the applicant, associated entities, associated persons, and third parties affected (see section IV(7) below).

(6) To Rule 2300 Item (g)

Information that has been granted confidential treatment by the Board should also be handled confidentially by the Commission. Submitting certain types of information would be unacceptable, even if the hurdles of Swiss law could be overcome, if it could not be excluded that such information will be made available to third parties (principle of non-proliferation), including the Attorney General of the United States, federal regulators other than your Commission, or state attorneys general (*cf*. Sec. 105(b)(5)(A) of the Act). We refer in that regard to our March Letter, section II.

IV. Comments on Individual Items of the Form

We will comment on the Form, following the order of items in the Form.

(1) To General Instructions, Item 6:

We refer to our separate comments in section III(5) above regarding confidential treatment.

(2) To Part I, Item 1.6 (*Associated Entities* of Applicant):

We refer to section III(1) above.

(3) To Part I, Item 1.7 (Applicant's Licenses):

This requirement should not relate to Swiss applicants, since the Swiss regulators (SWX, Federal Banking Commission, etc.) who issue licenses or similar authorizations do not normally associate any numbers therewith.

(4) To Part II (Listing of Applicants Public Company Clients):

While U.S. applicants will have to register in October 2003, non-U.S. applicants will have to register in April 2004 (or later, *cf*. section I(4) above). Thus the "Current Calendar Year" and the "Preceding Calendar Year" will be different for U.S. and non-U.S. applicants.

(5) To Part II, Item 2.1 (Issuers for which Applicant prepared Audit Reports during the Preceding Calendar Year) and 2.2 (Issuers for which Applicant Prepared Audit Reports During the Current Calendar Year), paragraphs c., d., and e.:

This demarcation between *audit services*, *other accounting services,* and *non-audit services* is difficult to draw for non-U.S. public accounting firms that are not used to these categories, and will be further complicated by the change of system occurring on December 15, 2003. This will force some of our members to take recourse to estimations and best guesses as to

which categories certain services fall into. We recommend instead using a two-pronged approach, differentiating (only) between audit services and non-audit services. This is the customary differentiation for most corporate governance regimes outside the U.S.

Further, information of the type sought here should generally be treated as confidential, as it will not be available in that form elsewhere.

(6) To Part II, Item 2.4 (Issuers for which Applicant *Played, or Expects to* Play, a *Substantial Role in* Audit):

Cf. section III(2) above.

(7) To Part V (Listing of Certain Proceedings Involving the Applicant):

Information of the type sought is considered confidential by all of the Swiss accounting firms, their associated persons, and third parties affected. Consent from third parties affected (other than issuers), which would be necessary for confidentiality and data protection purposes, would be impossible to obtain (*cf.* item II(3) above). We also would like to draw your attention to the fact that this type of information has never been made public before, and public disclosure of information of this type would be a novelty for Swiss business, and not in accordance with the Swiss legal system.

Public disclosure of this type of information would violate the personal rights of persons involved, and the confidentiality interests of employees, clients, and third parties with potentially disastrous effects. The disclosure of pending procedures would also violate the principle of presumed innocence.

Public disclosure of this type of information would lead to a *de facto* discrimination of Swiss registered accounting firms with respect to accounting firms in Switzerland not subject to the Act, and might also expose them to the risk of law suits (of an imitative or consequential nature) that otherwise would not have been brought against the registered Swiss firm.

Given the practical difficulty if not impossibility of gathering the information sought, the conflict with Swiss criminal provisions against economic espionage and acting in favor of a foreign state, and the potentially serious practical consequences for a Swiss public accounting firm, we propose that disclosure under items 5.1 through 5.4 of the Form be limited to (i) procedures pending in connection with issuers, and (ii) information and data whose release: (a) would not require consent from third parties other than the associated entities or associated persons of such public accounting firm; (b) would not conflict with the Swiss criminal provisions referred to above; or (c) could be effected on a no-name basis.

The information should in all cases be treated as confidential.

(8) To Part IV Item 6.1

Since this type of information is already being filed and made publicly available, we consider this requirement duplicative and superfluous.

(9) To Part VIII, Item 8.1 (Consents to Cooperate with the *Board*):

As indicated above, the required consents and statements could not be given at this moment in time, and can most likely not be given in March or April 2004 either

We therefore propose that the requirement to submit consents covering the issues addressed in Items 8.1 a. through c. be postponed until a common understanding of the scope and nature of the exemptions and the effects of the Swiss legislative measures has been reached between your Commission, the PCAOB, and their Swiss counterparts.

Alternatively, the wording of these Consents would have to be amended to reflect the limitations of non-U.S. law in a way that corresponds to Rule 2105.

V. Consents to be Provided by Foreign Public Accounting Firms

The Rules and Form do not address the issue of the consents deemed given by foreign public accounting firms who issue an opinion or otherwise perform material services within the meaning of Sec. 106(b) of the Act. The same limitations as to non-U.S. law that apply to the information submitted in the course of the registration pursuant to Rule 2105 should apply to such deemed consents.

VI. Conclusions

(1) Timetable

The timetable should be extended by at least one additional 360 day period for the registration by Swiss public accounting firms, and by a subsequent 360 day period for the investigative and disciplinary powers of the Board to take effect. This is necessary in order to give the Commission and the Board on the one hand and the Swiss Governmental Authorities and the Swiss accounting profession on the other hand the time necessary to establish the Swiss accounting oversight system and, on the basis of such Swiss oversight system, to establish a mutual understanding on the scope and nature of the investigative and disciplinary powers of the Board and on the exemptions to be granted to Swiss applicants from the related requirements:

(a) to furnish certain types of information otherwise required for registration that cannot be collected and provided by Swiss accounting firms for legal reasons, lack of third party consent, or due to practical difficulties

(b) to furnish the consents required under part VIII of the Form, and

(c) to subject themselves to the investigative (testimony, work paper production) and disciplinary powers of the Board.

(2) Limitations of non-U.S. Law

The limitations of non-U.S. law as set forth in Rule 2105 should apply also to the consents required under Item 8 of the Form, to the investigative and disciplinary powers of the Board, and to the deemed consents pursuant to Sec.106(b) of the Act.

(3) Dialogue, Interplay, and Equal Treatment

The Board, your Commission, and the Swiss Governmental Authorities should establish an appropriate mechanism of dialogue and interplay between the Board and the envisaged Swiss public accounting oversight body. In any event we trust that Swiss applicants will be treated equally with other non-U.S. applicants in a comparable situation.

We appreciate the opportunity to express our concerns and to offer you our insights on implementing the Act. We look forward to continuing this discussion until a solution has been found that achieves our common cause, while fairly balancing the sometimes conflicting interests of the parties involved.

Respectfully submitted,

Swiss Institute of Certified Accountants and Tax Consultants

Andreas Müller
Chairman

Walter Hess
General Secretary

Attachment: Letter of the Institute to the PCAOB dated March 27, 2003

Comptroller General of the United States

United States General Accounting Office
Washington, DC 20548

September 3, 2003

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

Subject: Proposed Rules on Inspections of Registered Public Accounting Firms

This letter provides the U.S. General Accounting Office's (GAO) comments on the Public Company Accounting Oversight Board's (PCAOB) July 28, 2003, proposed rules on accounting firm inspections, as mandated by the Sarbanes-Oxley Act of 2002.

GAO supports improved transparency and accountability in the accounting profession, and we believe that the proposed inspection rules will help in this endeavor. In finalizing the rules on inspections, we urge the PCAOB to consider the important issue of coordination with the profession's self-regulatory peer review program in order to avoid duplication and to minimize the burden on CPA firms that are required to undergo both a PCAOB inspection and a peer review.

GAO envisions a system of coordination in which peer reviewers would place appropriate reliance on a firm's PCAOB inspection report such that peer reviewers could use this information to possibly reduce the scope of their peer review, as appropriate. In order to make such a system possible, peer reviewers would need specific information and access to documentation on the scope of the inspections or information from the PCAOB on the specific level of assurance and reliance that can be placed on the inspection reports for purposes of planning the scope of the peer review engagement.

Coordination of effort between PCAOB inspections and peer reviews is particularly important because many CPA firms are subject to the peer review requirements of *Government Auditing Standards* promulgated by the GAO under the statutory authority awarded to the Comptroller General of the United States. For example, the following laws and regulations require peer reviews as applicable under *Government Auditing Standards:*

- The Inspector General Act of 1978, as amended, 5 U.S.C. App. (2000), requires that federal inspectors general appointed under the IG Act comply with *Government Auditing Standards* for audits of federal establishments, organizations, programs, activities, and functions. The act further states that the inspectors general shall take appropriate steps to assure that any work performed by nonfederal auditors complies with *Government Auditing Standards*.

- The Chief Financial Officers Act of 1990 (Public Law 101-576), as expanded by the Government Management Reform Act of 1994 (Public Law 103-356), requires that *Government Auditing Standards* be followed in audits of certain executive branch departments' and agencies' financial statements.

- The Single Audit Act Amendments of 1996 (Public Law 104-156) require that *Government Auditing Standards* be followed in audits of state and local governments and nonprofit entities that expend federal awards. The Office of Management and Budget (OMB) Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, which provides the government wide guidelines and policies on performing audits to comply with the Single Audit Act, also requires the use of *Government Auditing Standards*.

- The Federal Deposit Insurance Corporation (FDIC) requires peer reviews of firms that audit depository institutions as required by the FDIC Improvement Act of 1991.

- Other laws, regulations, and authoritative sources require the use of *Government Auditing Standards*. For example, some state and local laws and regulations require auditors at the state and local levels of government to follow *Government Auditing Standards*. Also, the terms of an agreement or contract may require auditors to comply with *Government Auditing Standards*. Federal audit guidelines pertaining to program requirements, such as those issued for Housing and Urban Development programs and Student Financial Aid programs, also require that *Government Auditing Standards* be followed.

Many PCAOB-registered public accounting firms, including all big four firms and numerous other CPA firms, are subject to the above peer review requirements and thus will be required to undergo both a PCAOB inspection as well as a peer review. Because the PCAOB's mandate only allows for inspections of a firm's public company audits, the PCAOB's inspections will not fully cover the requirements of the other peer reviews.

The American Institute of Certified Public Accountants (AICPA) recently released an exposure draft of proposed professional standards for performing and reporting on peer review engagements. Enclosed is a copy of GAO's letter commenting on the AICPA's proposed standards, in which we urge coordination of the peer review program with the PCAOB inspection program.

We believe that coordination between the relevant key stakeholders is called for before both the PCAOB's and the AICPA's standards are finalized. As a key stakeholder, we are happy to participate in any relevant coordination efforts.

We thank you for considering our comments on this very important issue.

Sincerely yours,

David M. Walker
Comptroller General
of the United States

Enclosure

cc: The Honorable William H. Donaldson, Chairman
Securities and Exchange Commission

The Honorable William J. McDonough, Chairman
Public Company Accounting Oversight Board

William F. Ezzell, Jr., Chair
American Institute of Certified Public Accountants

Barry C. Melancon, President and CEO
American Institute of Certified Public Accountants

Mr. Anthony Lynn
Chair, AICPA Peer Review Program

Mr. Gary Freundlich
Director, AICPA Peer Review Program

GAO
Accountability * Integrity * Reliability

Comptroller General of the United States

United States General Accounting Office
Washington, DC 20548

September 3, 2003

Mr. Anthony Lynn
Chair, AICPA Peer Review Program

Mr. Gary Freundlich
Director, AICPA Peer Review Program
American Institute of Certified Public Accountants
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Jersey City, NJ 07311-3881

Subject: Exposure Draft: Proposed Revisions to the AICPA *Standards for Performing and Reporting on Peer Reviews*

This letter provides the U. S. General Accounting Office's (GAO) comments on the AICPA's May 30, 2003, exposure draft of proposed revisions to the *AICPA Standards for Performing and Reporting on Peer Reviews (Standards)* and Interpretations to the *Standards.* We commend the AICPA's efforts to reevaluate the administration, performance, reporting objectives, and overall effectiveness of peer reviews conducted under the AICPA Standards. We support the AICPA's goal of designing, implementing, and maintaining a preeminent program that monitors the quality of an audit organization's accounting and auditing practice, and we are especially pleased that the proposed standards

- clearly identify audit organization and peer reviewer responsibilities during peer review, and
- require that individuals serving on peer review teams meet certain qualifications and conditions.

As presently structured, the peer review program is a critical element of the self-regulatory system used to maintain confidence and trust in our nation's capital markets. The peer review program is essential to maintaining and improving audit quality involving public companies, non-public companies, governmental, not-for-profit, and other types of entities. We are providing specific suggestions to further strengthen the peer review program in the following areas:

- coordination with PCAOB inspections,
- transparency of peer review results,
- a risk-based approach for peer review frequency, and
- a new name/title for "peer review".

In enclosures to this letter, we also provide specific recommendations for (1) modifying the peer review report wording to better reflect the work performed and to improve report clarity and transparency, (2) enhancing independence requirements, and (3) enhancing reviewer qualifications.

Coordination between peer reviews and PCAOB inspections

This is an especially opportune time to reevaluate peer review standards because the Public Company Accounting Oversight Board (PCAOB) has recently issued proposed rules for inspections of registered public accounting firms, as mandated by the Sarbanes-Oxley Act. The overlapping roles of the PCAOB inspectors and the peer reviewers pose challenges for the profession and should be carefully analyzed as the AICPA revises its standards. Critical issues to be resolved include information sharing and degree of reliance placed on each other's work. The AICPA should consider how the inspection and review functions of the PCAOB and the self-regulatory peer reviews could be jointly used to efficiently and effectively achieve their common objectives.

The PCAOB is developing procedures for inspections and enforcement of U.S. firms that audit publicly traded companies and plans to begin full inspections of these firms next year. In GAO's comment letter to the PCAOB on the proposed inspection rules, we urged the PCAOB to consider the issue of coordination with the profession's self-regulatory peer review program prior to finalizing any related requirements in order to avoid duplication and to minimize the burden on CPA firms that are required to undergo both a PCAOB inspection and a peer review. At the same time, we would also urge the AICPA to coordinate its peer review program with the PCAOB inspection program.

One possible coordination approach would involve peer reviewers placing appropriate reliance on a firm's PCAOB inspection report such that peer reviewers could use this information to possibly reduce the scope of their peer review as appropriate. In order to make such a system possible, peer reviewers would need specific information and access to documentation on the scope of the inspections or information from the PCAOB on the specific level of assurance and reliance that can be placed on the inspection reports for purposes of planning the scope of the peer review engagement. Other coordination approaches are also possible and should be considered, including determining the appropriate scope and targeting of peer review activities.

Coordination of effort between peer reviews and PCAOB inspections is particularly important because many CPA firms receiving PCAOB inspection are also subject to the peer review requirements of *Government Auditing Standards* promulgated by the GAO under the statutory authority awarded to the Comptroller General of the United States. For example, the following laws and regulations require peer reviews as applicable under *Government Auditing Standards:*

- The Inspector General Act of 1978, as amended, 5 U.S.C. App. (2000), requires that federal inspectors general appointed under the IG Act comply with *Government Auditing Standards* for audits of federal establishments, organizations, programs, activities, and functions. The act further states that the inspectors general shall take appropriate steps to assure that any work performed by nonfederal auditors complies with *Government Auditing Standards*.

- The Chief Financial Officers Act of 1990 (Public Law 101-576), as expanded by the Government Management Reform Act of 1994 (Public Law 103-356), requires that *Government Auditing Standards* be followed in audits of certain executive branch departments' and agencies' financial statements.

- The Single Audit Act Amendments of 1996 (Public Law 104-156) require that *Government Auditing Standards* be followed in audits of state and local governments and nonprofit entities that expend federal awards. The Office of Management and Budget (OMB) Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, which provides the government wide guidelines and policies on performing audits to comply with the Single Audit Act, also requires the use of *Government Auditing Standards*.

- The Federal Deposit Insurance Corporation (FDIC) requires peer reviews of firms that audit depository institutions as required by the FDIC Improvement Act of 1991.

- Other laws, regulations, and authoritative sources require the use of *Government Auditing Standards*. For example, some state and local laws and regulations require auditors at the state and local levels of government to follow *Government Auditing Standards*. Also, the terms of an agreement or contract may require auditors to comply with *Government Auditing Standards*. Federal audit guidelines pertaining to program requirements, such as those issued for Housing and Urban Development programs and Student Financial Aid programs, also require that *Government Auditing Standards* be followed.

PCAOB inspections will have two phases: (1) review of the firm's quality control policies and (2) review of engagements to determine if the firm's quality control policies are followed. After completing an inspection, the PCAOB will issue a confidential report on the engagement results to the firm, the SEC, and appropriate state regulators.

Communication and working relationship opportunities for efficiency and effectiveness exist between the peer review program and the PCAOB. Factors to consider include

- the level of assurance that peer reviewers can place on PCAOB inspection reports,
- whether the PCAOB will share with the AICPA or with peer reviewers information concerning the scope of its inspection,

- whether peer review reports should disclose the degree of reliance placed on PCAOB inspection reports, and
- whether peer reviewers should select sample engagements for review from the population of all engagements performed by the firm during the year under review or only from a population of audits excluding publicly traded companies.

Greater transparency of peer review results

GAO supports making peer review reports, letters of comment, and response letters generally available to parties contracting for audit services and others with a "need to know" or on a request basis. GAO also supports making the peer review reports publicly available (without the letters of comment and response letters). Increased availability of this information will improve transparency of the peer review process and help demonstrate the valuable services and quality products provided by the profession.

Government Auditing Standards currently require audit organizations to provide peer review reports and letters of comment to parties contracting for audit or attestation services as well as to auditors who rely on the audit organization's work. The standards also require government audit organizations to transmit their external peer review reports to appropriate oversight bodies. The standards also recommend making peer review reports and letters of comment available to the public upon request.

Risk-based approach for peer review frequency

The effectiveness of the peer review process can be improved by bringing greater scrutiny to those audit organizations that have experienced problems. The proposed standards call for an initial peer review within 18 months after a firm's first engagement requiring a peer review, and every 3 years and 6 months after the year-end of the previous review. We believe that specific provisions should be added to require firms to have more frequent peer reviews if the previous peer review has identified significant deficiencies or problems. The PCAOB has indicated it is adopting a risk-based approach for determining the frequency and scope of its inspections procedures. Similarly, when planning the frequency and scope of engagement procedures, peer review teams and administrators should consider the pattern and pervasiveness of deficiencies reported in past inspections and peer reviews.

New name/title for "peer review"

In its proposal, the Board also requested comments on whether the terms "peer review," "system review," "engagement review," and "report review" appropriately reflect the enhanced peer review program, as proposed. The three levels of engagements under the peer review program as presented in the current standards and in the exposure draft have significantly different levels of scope and assurance. As explained in the standards, the three levels of peer review are

- system reviews – for audit organizations that perform audits, examination-level attestation engagements, or engagements in accordance with *Government Auditing Standards*. A system review is intended to provide a reasonable basis for the reviewer's opinion.

- engagement reviews - for audit organizations that perform only compilations, reviews, and/or attestation engagements performed at the review or agreed-upon-procedures level. In an engagement review, the reviewer provides limited assurance that the review and attestation engagements submitted for review conform with the requirements of professional standards.

- report reviews - for audit organizations that compile financial statements that omit substantially all disclosures. In a report review, the reviewer provides no opinion or assurances; however, the reviewer may provide comments and recommendations on conforming financial statements and accountant's reports with professional standards with the objective of enhancing the overall quality of compilation engagements.

Because the three levels of peer review are so significantly different in terms of scope and level of assurance provided, we believe that the generic use of the term "peer review" when referring to a specific engagement is confusing and creates an expectation gap when referring to an engagement review or a report review. Therefore, we propose using the term "peer review" only for system reviews, and we recommend that the Board rename the three different levels of engagements as follows:

1. Peer Review of CPA Firm's Quality Control System for Audit and Attest Engagements
2. Independent Review of CPA Firm's Documentation for Compilation and Review Engagements
3. Independent Assessment or Review of CPA Firm's Compilation Reports.

We also recommend using the above descriptions as the titles of the three reviewer's reports.

Other Matters

We also offer in enclosures 1 to 3 the following recommendations along with specific wording changes. The nature of our suggested changes is as follows:

- Modify the peer review report language concerning firm competencies to perform accounting and auditing engagements in accordance with professional standards to more accurately reflect the work performed by the reviewer.

- Strengthen independence requirements by precluding firms related through joint participation in associations that provide marketing services to members from performing peer reviews of other firms that are members of the same association.

- Broaden reviewer qualifications to allow participation on peer review teams by qualified CPAs—such as academics, retired government auditors, and retired CPA firm auditors—who are employed as consultants or contractors by a CPA firm.

We believe that coordination between the relevant key stakeholders is called for before both the AICPA's and the PCAOB's standards are finalized. As a key stakeholder, we are happy to participate in any relevant coordination efforts.

Thank you for considering our comments on these very important issues.

Sincerely yours,

David M. Walker
Comptroller General
of the United States

Enclosures – 3

cc: William F. Ezzell, Jr., Chair
American Institute of Certified Public Accountants

Barry C. Melancon, President and CEO
American Institute of Certified Public Accountants

William H. Donaldson, Chairman
Securities and Exchange Commission

William J. McDonough, Chairman
Public Company Accounting Oversight Board

Office of the Secretary
Public Company Accounting Oversight Board

Enclosure 1

Simplifying Report Wording

GAO Proposed Change:

The peer review report language should cover the firm's compliance with professional standards rather than the firm's competencies demonstrated to perform accounting and auditing engagements in accordance with professional standards.

The wording in the illustrated reports also should convey more concisely the work performed and the conclusions reached as a result of the engagement.

Rationale for and Benefits of Proposed Change:

In a peer review engagement, the reviewer tests a firm's quality control system and the output from the system. This testing and the resulting evidence gathered do not provide sufficient basis for expressing an opinion on the firm's collective competencies (knowledge, skills, and abilities) demonstrated to perform accounting and auditing engagements. Modification to the report language is needed to better reflect the work performed and reduce the likelihood of creating an expectations gap with report users.

In addition, we are also making specific changes to write the report in an active voice to improve clarity and transparency in the profession's self-regulatory structure.

Suggested Wording of Proposed Change:

Page 39 Paragraph 135 Appendix D: Illustration of an Unmodified Report on a System Review

Title: Peer Review of Audit Firm's Quality Control System

We have reviewed the accounting and auditing practice of [Name of firm] (the firm) for the year ended June 30, 20XX. Firm management is responsible for assuring that the firm's accounting and auditing practice is conducted in conformity with applicable professional standards. In addition, the firm is responsible for designing a system of quality control and complying with it in order to provide reasonable assurance that the firm complies with professional standards in all material respects. We are responsible for expressing our opinion on 1) the firm's compliance with professional standards in all material respects and 2) the firm's design of and compliance with its system of quality control. Our opinion is based on our examination of firm records and documentation during our review.

We performed our review under the American Institute of Certified Public Accountants' (AICPA) peer review program, and we complied with standards

established by the Peer Review Board of the AICPA. During our review, we read required representations from the firm, interviewed firm personnel and obtained an understanding of the nature of the firm's accounting and auditing practice, and the design of the firm's system of quality control sufficient to assess the risks implicit in the firm's practice. Based on our assessments, we selected engagements to test audit documentation for conformity with professional standards and compliance with the firm's system of quality control. The engagements we selected represented a cross-section of the firm's accounting and auditing practice with emphasis on higher-risk engagements. (The engagements selected included, among others, audits of Employee Benefit Plans, engagements performed under Governmental Auditing Standards, and audits of Depository Institutions with more than $500 million in assets.)[19] Our review of engagements included examining the firm's engagement documentation on significant risk areas and interviews of engagement personnel.

We also examined selected administrative files to assess the firm's compliance with Quality Control Standards issued by the AICPA. Prior to concluding the review, we reassessed the adequacy of our procedures and conducted an exit conference with firm management to discuss the results of our review. We believe that the procedures we performed provide a reasonable basis for our opinion.

In our opinion, [Name of Firm] complied with professional standards in all material respects on the engagements we reviewed that were performed during the year ended June 30, 20XX. In addition, the firm's system of quality control is designed to meet the requirements of the quality control standards established by the AICPA for an accounting and auditing practice and the firm complied with its quality control system during the year ended June 30, 20XX . For the engagements we reviewed, the firm's quality control system provided the firm with reasonable assurance of complying with professional standards in all material respects during the year ended June 30, 20xx.

(As is customary in a system review, we have issued a letter dated xx-xx-xx that details matters we detected during our review that were not of sufficient significance to affect the opinion expressed in this report [20])

page 43, paragraph 138. Appendix G: Illustrations of a Modified Report on a SystemReview

Paragraphs 1 – 3 of this report are the same as in the Unmodified report

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19 If the firm performs audits of Employee Benefit Plans, engagements performed under *Governmental Auditing Standards*, audits of Depository Institutions with more than $500 million in assets, or other engagements required to be selected by the Board in Interpretations, the engagements selected for review should be identified in the report.

[20] To be included if the review team issues a letter of comments with an unmodified or modified report.

During our review, we detected deficiencies, which are described below, that were significant enough to cause us to modify our opinion on the effectiveness of the firm's quality control system during the year ended June 30, 20xx. However, the pattern and pervasiveness of the deficiencies were not significant enough to cause us to issue a negative opinion on the firm's quality control system during the year ended June 30, 20xx. In our opinion, because of these deficiencies, [Name of Firm] complied with some but not all professional standards during the year ended June 30, 20XX. In addition, the firm's system of quality control is designed in a way that meets some but not all of the requirements of the quality control standards for an accounting and auditing practice established by the AICPA and the firm complied with some but not all of the requirements of its system of quality control during the year.

Page 52, Paragraph 144. Appendix M: Illustrations of an Adverse Report on a System Review

Paragraphs 1 – 3 of this report are the same as in the Unmodified report

In our opinion, [Name of Firm] did not comply with all professional standards in all material respects during the year ended June 30, 20_. In addition, the firm's system of quality control is not designed to meet the requirements of the quality control standards for an accounting and auditing practice established by the AICPA, and the firm did not comply with its quality control system during the year. As a result of these deficiencies, the firm's quality control system did not provide the firm with reasonable assurance of complying with professional standards during the year ended June 30, 20xx. Our opinion is based on deficiencies we detected during our review, which are described below.

Enclosure 2

Strengthening Independence Requirements

GAO Proposed Change:

Firms that are related through joint participation in associations that provide marketing services to members should be precluded from performing peer reviews of other firms that are members of the association.

Rationale for and Benefits of Proposed Change:

GAO's recommended change would demonstrate that the peer reviewers are independent in fact and in appearance and thus improve public confidence in the peer review system. We believe that members of these associations have economic incentives to help other members. This causes lack of independence in fact. Even if there are no explicit profit sharing arrangements, if a member firm receives less than

an unqualified peer review report, the stigma affects all the firms in the association. Thus peer reviewers who are members of the same association do not appear independent.

Suggested Wording of Proposed Change:

Page 35, *new paragraph* 131.6. If the reviewed firm and the reviewing firm are both members of an association that jointly markets member qualifications and services, independence is impaired.

Enclosure 3

Broadening Reviewer Qualifications.

GAO Proposed Change:

Qualification for service as a reviewer should allow participation on peer review teams by qualified CPAs who are employed as consultants for peer review engagements by a CPA firm and who satisfy all other qualifications for service as a reviewer.

Rationale for and Benefits of Proposed Change:

The proposed change would permit otherwise qualified CPAs, such as academics, retired government auditors, and retired CPA firm auditors, to participate on peer review engagements as consultants or contractors to the firm engaged to perform the review. This, in turn, would broaden the base of potential reviewers, would bring diverse perspectives to the peer review process, and would help assure an adequate supply of qualified reviewers.

Suggested Wording of Proposed Change:

Page 7, paragraph 31d. [an individual serving as a reviewer should–] have acquired appropriate knowledge and skills from current or recent management-level experience in accounting or auditing practice or from other sources such as experience with regulators (PCAOB, GAO, AICPA, or SEC).

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INSPECTION OF REGISTERED PUBLIC ACCOUNTING FIRMS	PCAOB Release No. 2003-019 October 7, 2003 PCAOB Rulemaking Docket Matter No. 006

Summary: After public comment, the Public Company Accounting Oversight Board (the "Board" or "PCAOB") has adopted rules on inspections of registered public accounting firms. Section 104(a) of the Sarbanes-Oxley Act of 2002 (the "Act") directs the Board to conduct a continuing program of inspections to assess the degree of compliance of each public accounting firm registered with the Board, and that firm's associated persons, with the Act, the rules of the Board, the rules of the Securities and Exchange Commission (the "Commission"), and professional standards in connection with the performance of audits, the issuance of audit reports, and related matters involving U.S. public companies. The proposal consists of 10 rules (PCAOB Rules 4000 through 4010) plus two related definitions. The Board will submit these rules to the Securities and Exchange Commission ("Commission") for approval pursuant to Section 107 of the Act. The Board's rules will not take effect unless approved by the Commission.

Board Contacts: Phoebe Brown, Special Counsel to Board Member Goelzer (202/207-9073; brownp@pcaobus.org), Michael Stevenson, Associate General Counsel (202/207-9054; stevensonm@pcaobus.org), or Chris Mandaleris, Deputy Director – Inspections (202/207-9057; mandalerisc@pcaobus.org).

* * *

Section 104(a) of the Act directs the Board to conduct a continuing program of inspections to assess the degree of compliance of each registered public accounting firm and associated persons of that firm with the Act, the Board's and the Commission's rules, and professional standards in connection with the performance of audits, the issuance of audit reports, and related matters involving U.S. public companies.[1/] Section 101(c)(3) of the Act provides that the Board shall "conduct inspections of registered public accounting firms, in accordance with section 104 and the rules of the Board." To implement this directive and to comply with Section 101(c)(3), the Board has adopted rules relating to inspections.[2/]

The rules adopted by the Board consist of 10 rules (PCAOB Rules 4000 through 4010) plus two related definitions. The text of these rules and a detailed discussion of each of the rules are attached as Appendices 1 and 2, respectively. Section A of this release provides a general overview of the operation of the rules. Section B of this release describes the changes made to the rules in response to public comments. Section C discusses special issues relating to non U.S. accounting firms.

A. Overview of the Rules on Inspections

Consistent with Section 104(a) of the Act, the Board's proposed rules subject public accounting firms that are registered with the Board to such regular and special inspections as the Board may from time-to-time conduct. The Board's rules establish a schedule for regular inspections that is consistent with Section 104(b)(1) of the Act, including annual inspections for firms that do the largest volume of audit work and at least triennial inspections for other firms that do some volume of audit work.[3/] Special

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[1/] This release uses the term "U.S. public companies" as shorthand for the companies that are "issuers" under the Act and the Board's rules. This includes domestic public companies, whether listed on an exchange or not, and foreign private issuers that have either registered, or are in the process of registering, a class of securities with the Commission or are otherwise subject to Commission reporting requirements.

[2/] The rules govern procedural matters concerning the Board's inspection program. Board staff will carry out particular inspections according to detailed, nonpublic inspection plans.

[3/] The rules do not provide for regular inspections of registered firms that do no audit work. The Board does not encourage the registration of firms that have no public company clients and are not actively seeking to develop a public company

inspections are not subject to an inspection schedule and will be conducted at such time as is necessary or appropriate to address issues that come to the Board's attention.

The Board's rules provide that a regular inspection will include, but is not limited to, the steps and procedures as specified in Sections 104(d)(1) and (2) of the Act and any other tests of the audit, supervisory, and quality control procedures of the firm as the Director of the Division of Registration and Inspections or the Board determines appropriate. In addition, the rules provide that special inspections will include all steps and procedures necessary or appropriate to address the issue or issues raised by the Board when it authorized the inspection.

The rules implement the authority and responsibility that the Act gives the Board to report information indicating possible violations of law or professional standards to the Commission, appropriate state regulatory authorities, and other regulators and law enforcement authorities. Similarly, the rules implement the Board's authority to commence its own investigation or disciplinary proceeding based on such information.

The rules also set forth a process by which a firm may submit written comments on a draft inspection report before the Board issues a final inspection report. The firm's response to the draft inspection report will be attached to and made part of the final inspection report. In addition, the rules implement the Act's requirement that portions of a final inspection report that deal with criticisms or potential defects in a firm's quality control systems may be made public only if the firm fails to address those matters to the Board's satisfaction within 12 months after the issuance of the final inspection report.

The rules provide that the Board may, at any time, publish reports concerning the procedures, findings, and results of its various inspections. These reports may include discussion of criticisms of, or potential defects in, quality control systems of any firm or firms that were the subject of a Board inspection. Under the rules, these published reports will not identify the firm or firms to which these criticisms relate, or at which the defects were found, unless the information has previously been made public pursuant to the Board's rules or other lawful means.

With the exception of the changes discussed below, the rules adopted today are substantially similar to the rules proposed by the Board on July 28, 2003. The operation of those rules was summarized in greater detail in PCAOB Release No. 2003-013 (July 28, 2003).

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clientele. See "Frequently Asked Questions Regarding Registration With the Board," Question #8, PCAOB Release No. 2003-011 (July 18, 2003).

B. Public Comment Process and Board Responses

The Board proposed inspection rules, and released them for public comment, on July 28, 2003. The Board received 16 written comment letters.[4/] In response to these comments, the Board's final rules both clarify and modify certain aspects of the proposal. Most significantly, the changes include –

- providing a definition of the term "appropriate state regulatory authority" (following the definition in the Act), and employing that term rather than referring to a "state agency, board, or other authority that has issued a license or certification number to the firm or person who engaged, or may have engaged in such act, practice, or omission authorizing such firm or person to engage in the business of auditing or accounting;"

- clarifying that a registered firm's and an associated person's duty to cooperate with an inspection includes cooperating and complying with any request made in furtherance of the Board's authority and responsibilities under the Act;

- more closely tracking the Act by allowing the Board the flexibility to make draft and final inspection reports available to a firm for review rather than providing by rule that the Board will necessarily transmit copies to the firm;

- adding a provision implementing the Act's procedural requirements concerning a firm's response to a draft inspection report;

- providing that the Board will notify the Commission and each appropriate state regulatory authority if the Board determines that a firm has satisfactorily addressed quality control defects and criticisms within the twelve-month period provided by the Act; and

- reorganizing portions of the rules to make clear that the overarching purpose of both regular and special inspections is to assess the degree of compliance with the Act, Board rules, Commission rules, and professional

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4/ The Board's responses to the comments are discussed in more detail in the section-by-section analysis in Appendix 2. The comment letters are available on the Board's Web site – www.pcaobus.org – and will be attached to the Board's Form 19b-4, to be filed with the Commission.

standards, in connection with the performance of audits, the issuance of audit reports, and related matters involving issuers.

C. Special Issues Relating to Non-U.S. Firms

The nature and scope of the Board's oversight over non-U.S. accounting firms that audit the financial statements of U.S. public companies is the subject of an ongoing dialogue between the Board and its foreign counterparts. As the Board has previously stated, the Board is committed to finding ways of accomplishing the oversight goals of the Act by coordinating in areas where there is a common programmatic interest without subjecting non-U.S. firms to unnecessary burdens. The adoption of these rules is not intended in any way to signal that the Board has already determined how its oversight should operate as to those firms. Before non-U.S. accounting firms are required to register with the Board, the Board intends to issue a release describing how it will carry out its inspection responsibilities with respect to such firms.

* * *

On the 7th day of October, in the year 2003, the foregoing was, in accordance with the bylaws of the Public Company Accounting Oversight Board,

ADOPTED BY THE BOARD.

/s/ J. Gordon Seymour
Acting Secretary

October 7, 2003

APPENDICES –

1. Rules Relating to Inspections

2. Section-by-Section Analysis of Inspection Rules

PCAOB
Public Company Accounting Oversight Board

Appendix 1 – Rules Relating to Inspections

SECTION 1. GENERAL PROVISIONS

Rule 1001. Definitions of Terms Employed in Rules.

When used in Rules, unless the context otherwise requires:

(a)(xi) Appropriate State Regulatory Authority

The term "appropriate state regulatory authority" means the State agency or other authority responsible for the licensure or other regulation of the practice of accounting in the State or States having jurisdiction over a registered public accounting firm or associated person thereof, with respect to the matter in question.

(p)(vi) Professional Standards

The term "professional standards" means –

(A) accounting principles that are –

(i) established by the standard setting body described in section 19(b) of the Securities Act of 1933, as amended by the Act, or prescribed by the Commission under section 19(a) of the Securities Act of 1933 or section 13(b) of the Securities Exchange Act of 1934; and

(ii) relevant to audit reports for particular issuers, or dealt with in the quality control system of a particular registered public accounting firm; and

(B) auditing standards, standards for attestation engagements, quality control policies and procedures, ethical and competency standards, and independence standards (including rules implementing Title II of the Act) that the Board or the Commission determines –

(i) relate to the preparation or issuance of audit reports for issuers; and

(ii) are established or adopted by the Board under section 103(a) of the Act, or are promulgated as rules of the Commission.

PCAOB
Public Company Accounting Oversight Board

SECTION 4. INSPECTIONS

Rule 4000. General

Every registered public accounting firm shall be subject to all such regular and special inspections as the Board may from time-to-time conduct in order to assess the degree of compliance of each registered public accounting firm and associated persons of that firm with the Act, the Board's rules, the rules of the Commission, and professional standards, in connection with its performance of audits, issuance of audit reports, and related matters involving issuers. Inspection steps and procedures shall be performed by the staff of the Division of Registration and Inspections, and by such other persons as the Board may authorize to participate in particular inspections or categories of inspections.

Rule 4001. Regular Inspections

In performing a regular inspection, the staff of the Division of Registration and Inspections and any other person authorized by the Board to participate in the inspection shall take such steps, and perform such procedures, as the Board determines are necessary or appropriate**.** Such steps and procedures must include, but need not be limited to, those set forth in Section 104(d)(1) and (2) of the Act and such other tests of the audit, supervisory, and quality control procedures of the firm as the Director of the Division of Registration and Inspections or the Board determines.

Rule 4002. Special Inspections

In performing a special inspection, the staff of the Division of Registration and Inspections and any other person authorized by the Board to participate in the inspection shall take such steps, and perform such procedures, as are necessary or appropriate concerning the issue or issues specified by the Board in connection with its authorization of the special inspection.

Note: Under Section 104(b)(2) of the Act, the Board may authorize a special inspection on its own initiative or at the request of the Commission.

Rule 4003. Frequency of Inspections

(a) During each calendar year, beginning no later than the calendar year following the calendar year in which its application for registration with the

Board is approved, a registered public accounting firm that, during the prior calendar year, issued audit reports with respect to more than 100 issuers shall be subject to a regular inspection.

(b) At least once in every three calendar years, beginning with the three-year period following the calendar year in which its application for registration with the Board is approved, a registered public accounting firm that, during any of the three prior calendar years, issued an audit report with respect to at least one, but no more than 100, issuers, or that played a substantial role in the preparation or furnishing of an audit report with respect to at least one issuer, shall be subject to a regular inspection.

(c) With respect to a registered public accounting firm that has filed a completed Form 1-WD under Rule 2107, the Board shall have the discretion to forego any regular inspection that would otherwise commence during the period beginning on the fifth day following the filing of the completed Form 1-WD and continuing until the firm's registration is deemed withdrawn or the firm withdraws the Form 1-WD.

Rule 4004. Procedure Regarding Possible Violations

If the Board determines that information obtained by the Board's staff during any inspection indicates that the registered public accounting firm subject to such inspection, any associated person thereof, or any other person, may have engaged, or may be engaged, in any act, practice, or omission to act that is or may be in violation of the Act, the rules of the Board, any statute or rule administered by the Commission, the firm's own quality control policies, or any professional standard, the Board shall, if it determines appropriate –

(a) report information concerning such act, practice, or omission to –

(1) the Commission; and

(2) each appropriate state regulatory authority; and

(b) commence an investigation of such act, practice, or omission in accordance with Section 105(b) of the Act and the Board's rules thereunder or a disciplinary proceeding in accordance with Section 105(c) of the Act and the Board's rules thereunder.

Note: The Board may, as appropriate, make referrals or report information to regulatory and law enforcement agencies other than those specifically described in Rule 4004.

Rule 4005. Record Retention and Availability

[Reserved]

Rule 4006. Duty to Cooperate With Inspectors

Every registered public accounting firm, and every associated person of a registered public accounting firm, shall cooperate with the Board in the performance of any Board inspection. Cooperation shall include, but is not limited to, cooperating and complying with any request, made in furtherance of the Board's authority and responsibilities under the Act, to –

(1) provide access to, and the ability to copy, any record in the possession, custody, or control of such firm or person, and

(2) provide information by oral interviews, written responses, or otherwise.

Rule 4007. Procedures Concerning Draft Inspection Reports

(a) The Director of the Division of Registration and Inspections shall make a draft inspection report available for review by the firm that is the subject of the report. The firm may, within the 30 days after the draft inspection report is first made available for the firm's review, or such longer period as the Board may order, submit to the Board a written response to the draft report.

(b) (1) In submitting a response pursuant to paragraph (a), the firm may indicate any portions of the response for which the firm requests confidential treatment under Section 104(f) of the Act, and may supply any supporting authority or other justification for according confidential treatment to the information.

(2) The Board shall attach to, and make part of the inspection report, any response submitted pursuant to paragraph (a), but shall redact from the response attached to the inspection report any information for which the firm requested confidential treatment and which it is reasonable to characterize as confidential.

(c) After receiving and reviewing any response letter pursuant to paragraph (a) of this rule, the Board may take such action with respect to the draft inspection report as it considers appropriate, including adopting the draft report as the final report, revising the draft report, or continuing or supplementing the inspection before issuing a final report. In the event that, prior to issuing a final report, the Board directs the staff to continue or supplement the inspection or revise the draft report, the Board may, in its discretion, afford the firm the opportunity to review any revised draft inspection report.

Rule 4008. Procedures Concerning Final Inspection Reports

Promptly following the Board's issuance of a final inspection report, the Board shall –

(a) make the final report available for review by the firm that is the subject of the report;

(b) transmit to the Commission the final report, any additional letter or comments by the Board or the Board's inspectors that the Board deems appropriate, and any response submitted by the firm to a draft inspection report; and

(c) transmit to each appropriate state regulatory authority, in appropriate detail, the final report, any additional letter or comments by the Board or the Board's inspectors that the Board deems appropriate, and any response submitted by the firm to a draft inspection report.

Rule 4009. Firm Response to Quality Control Defects

(a) With respect to any final inspection report that contains criticisms of, or potential defects in, the quality control systems of the firm under inspection, the firm may submit evidence or otherwise demonstrate to the Director of the Division of Registration and Inspections that it has improved such systems, and remedied such defects no later than 12 months after the issuance of the Board's final inspection report. After reviewing such evidence, the Director shall advise the firm whether he or she will recommend to the Board that the Board determine that the firm has satisfactorily addressed the criticisms or defects in the quality control system of the firm identified in the final inspection report and, if not, why not.

(b) If the Board determines that the firm has satisfactorily addressed the criticisms or defects in the quality control system, the Board shall provide notice of that determination to the Commission and to any appropriate state regulatory authority to which the Board had supplied any portion of the final inspection report.

(c) The Board shall notify the firm of its final determination concerning whether the firm has addressed the criticisms or defects in the quality control system of the firm identified in the final inspection report to the satisfaction of the Board.

(d) The portions of the Board's inspection report that deal with criticisms of or potential defects in quality control systems that the firm has not addressed to the satisfaction of the Board shall be made public by the Board –

(1) upon the expiration of the 12-month period described in paragraph (a) of this rule if the firm fails to make any submission pursuant to paragraph (a); or

(2) upon the expiration of the period in which the firm may seek Commission review of any board determination made under paragraph (b) of this rule, if the firm does not seek Commission review of the Board determination; or

(3) unless otherwise directed by Commission order or rule, 30 days after the firm formally requests Commission review pursuant to Section 104(h)(1)(B) of the Act.

Rule 4010. Board Public Reports

Notwithstanding any provision of Rules 4007, 4008, and 4009, the Board may, at any time, publish such summaries, compilations, or other general reports concerning the procedures, findings, and results of its various inspections as the Board deems appropriate. Such reports may include discussion of criticisms of, or potential defects in, quality control systems of any firm or firms that were the subject of a Board inspection, provided that no such published report shall identify the firm or firms to which such criticisms relate, or at which such defects were found, unless that information has previously been made public in accordance with Rule 4009, by the firm or firms involved, or by other lawful means.

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Appendix 2 – Section-by-Section Analysis of Inspection Rules

There are 10 inspection rules (PCAOB Rules 4000 through 4010, with Rule 4005 reserved) plus related definitions (PCAOB Rule 1001(a)(xi) and PCAOB Rule 1001(p)(vi)). Each of the rules is discussed below.

Rule 1001 – Definitions of Terms Employed in Rules

Appropriate State Regulatory Authority

As discussed in more detail below, the Board has decided to add a definition of the term "appropriate state regulatory authority." The definition of that term in Rule 1001(a)(xi) is identical to the definition of the same term in Section 2(a)(1) of the Act.

Professional Standards

The definition of professional standards in Rule1001(p)(vi) references that in Section 2(a)(10) of the Act. It should be noted that the term "professional standards" is broader than "auditing and related professional practice standards," which is defined in Rule 1001(a)(viii) of the Board's rules.

A few commenters suggested that the Board clarify this term, particularly in conjunction with reporting possible violations under Rules 4004 and identifying criticisms or potential defects in quality control systems under Rule 4009. The Board has clarified the use of this term vis à vis these two rules below.

Rule 4000 – General

Consistent with Section 104(a) of the Act, Rule 4000 subjects every registered public accounting firm to all such regular and special inspections as

the Board may from time-to-time conduct in order to assess the degree of compliance of each registered public accounting firm and associated persons of that firm with the Act, the Board's rules, the rules of the Commission, and professional standards, in connection with its performance of audits, issuance of audit reports, and related matters involving issuers. The rule provides that inspection steps and procedures will be performed by the staff of the Division of Registration and Inspections and by such other persons authorized by the Board.

To address one commenter's concern about the scope of the Board's inspections, the Board has clarified in this rule that registered public accounting firms will be subject to regular and special inspections "in order to assess the degree of compliance of each registered public accounting firm and associated persons of that firm with the Act, the Board's rules, the rules of the Commission, and professional standards, in connection with its performance of audits, issuance of audit reports, and related matters involving issuers."

Several commenters requested that the Board clarify the types of persons covered by the phrase "such other persons authorized by the Board" and whether such persons would be subject to the Board's Ethics Code and certain confidentiality agreements. The Board anticipates that "other persons authorized by the Board" to perform an inspection will include consultants and staff of the

Board, other than staff of the Board's Division of Registration and Inspections.[5/] The Board does not anticipate that practicing accountants associated with public accounting firms will participate in the Board's inspections.

Rule 4001 – Regular Inspections

Rule 4001 requires that in performing a regular inspection, the staff of the Division of Registration and Inspections and other authorized persons take such steps and perform such procedures as the Board determines are necessary or appropriate. The rule requires the inclusion of steps and procedures set forth in Sections 104(d)(1) and (2) of the Act and such other tests of the audit, supervisory, and quality control procedures of the firm as the Director of the Division of Registration and Inspections or the Board determines.

Section 104(d)(1) requires the Board to "inspect and review engagements of the firm (which may include audit engagements that are the subject of ongoing litigation or other controversy between the firm and 1 or more third parties), performed at various offices and by various associated persons of the firm, as

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[5/] The Board anticipates using some consultants to supplement its permanent staff on certain inspections during its first cycle of inspections. All inspections will be led by a senior staff member of the PCAOB's Division of Registration and Inspections. Once the first cycle of inspections is complete and the Board has further added to its inspections staff, the Board anticipates that consultants will be primarily used as technical specialists, as needed, on discrete issues in the course of inspections. Non-staff that participate in the Board's inspections will be subject to relevant provisions of the Board's Ethics Code, including the same confidentiality requirements to which the Board's inspection staff is subject.

selected by the Board." Section 104(d)(2) requires the Board to "evaluate the sufficiency of the quality control system of the firm, and the manner of documentation and communication of that system by the firm."

Rule 4002 – Special Inspections

Rule 4002 requires that in performing a special inspection, the staff of the Division of Registration and Inspections and other authorized persons take such steps and perform such procedures, as are necessary or appropriate concerning the issue or issues specified by the Board in connection with its authorization of the special inspection. A note to the rule makes clear that under Section 104(b)(2) of the Act, the Board may authorize a special inspection on its own initiative or at the request of the Commission. Several commenters expressed uncertainty about whether, under Rule 4002, Board approval would be required to authorize a special inspection. Since the rule requires Board authorization, like any other Board action, the vote of a majority of the Board members present at a meeting at which a quorum of Board members is present is required to authorize a special inspection.[6/]

Further, a number of commenters requested additional guidance as to the type of information that would trigger a special inspection. In order to retain flexibility and avoid a formulaic approach to such inspections, the Board has

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[6/] See Article 4.3 of the PCAOB's bylaws.

decided not to develop a set threshold or list of criteria that may lead to the commencement of a special inspection. For example, while the Board will consider the source of information it receives, the Board may find that in certain circumstances anonymous tips or media stories may be sufficient to begin a special inspection. Similarly, in order to retain flexibility, the Board has decided not to include a specific notice provision in the rule, as suggested by one commenter. However, as a practical matter, the Board's staff intends to give firms subject to special inspections reasonable notice in advance of commencing such inspections.

Some commenters requested that the Board clarify the difference between an investigation and a special inspection. In response to this comment, the Board notes that special inspections are not intended to serve the same function as a Board investigation, which will be conducted pursuant to the Board's investigative rules and procedures. Special inspections are designed to address issues that come to the Board's attention and, as a general matter, will be performed in order to assess the degree of compliance of each registered public accounting firm and associated persons of that firm with the Act, the Board's rules, the rules of the Commission, and professional standards, in connection with its performance of audits, issuance of audit reports, and related matters involving issuers. Nevertheless, any inspection – whether a regular inspection or

a special inspection – may result in a particular matter being turned over to the Board's enforcement staff for investigation.

Rule 4003 – Frequency of Inspections

Rule 4003 sets forth the schedule for regular inspections. Rule 4003(a) is consistent with the schedule for larger registered public accounting firms set forth in Section 104(b)(1)(A) of the Act. This rule requires that beginning no later than the year after its registration with the Board has been approved, a registered public accounting firm that, during the prior calendar year, issued audit reports with respect to more than 100 issuers will be subject to a regular inspection.[7/] Rule 4003(b) is consistent with the schedule for smaller registered public accounting firms set forth in Section 104(b)(1)(B) of the Act. Rule 4003(b) requires that beginning with the three-year period following the calendar year in which its registration with the Board has been approved, a registered public accounting firm that, during any of the three prior calendar years, issued audit reports with respect to at least one, but no more than 100, issuers, or that played a substantial role in the preparation or furnishing of an audit report with respect to at least one issuer, will be subject to a regular inspection.

In accordance with Section 104(b)(2) of the Act, the Board has added Rule 4003(c) which adjusts the regular inspection schedule for a registered

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[7/] A technical change has been made to Rule 4003(a) and (b). This change does not affect the rule's meaning.

public accounting firm that has requested to withdraw from registration by filing a completed Form 1-WD.[8/] Specifically, the rule provides that the Board shall have discretion not to conduct a regular inspection that would otherwise commence during the period beginning on the fifth day following the filing of the completed Form 1-WD and continuing until the firm's registration is deemed withdrawn or the firm withdraws its Form 1-WD.

One commenter noted that the Board may wish to add more flexibility in its rules to allow regular inspections to be conducted more frequently than the statutory schedule in Section 104(b)(1) allows. To address this concern, the Board notes its authority under Section 104(b)(2) to adjust inspection schedules set forth in Section 104(b)(1) if it finds that different inspection schedules are consistent with the purposes of the Act, the public interest, and the protection of investors. While the Board has decided to align the regular inspection schedule with that set forth in Section 104(b)(1) of the Act as an initial matter, the Board may decide at a later point, given subsequent developments and the benefit of experience with its inspection program, that adjustments to the schedule are appropriate.

Several commenters recommended that the Board coordinate the timing of its regular inspections with the peer review process. At this time, in order to

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[8/] See PCAOB Release No. 2003-016 (September 29, 2003).

retain flexibility in performing its regular inspections, the Board has decided not to commit to align its regular inspections with the peer review process. The Board understands that firms that register with the Board will also have practices relating to audits other than public company audits, and that state regulatory requirements continue to involve a peer review process related to those practices. The Board expects its inspections staff to make any appropriate recommendations concerning coordination with such reviews as the staff gains experience with issues relating to the implementation of the Board's inspection responsibilities.

Rule 4004 – Procedure Regarding Possible Violations

Consistent with Section 104(c) of the Act, Rule 4004 sets forth procedures which the Board is required to follow with respect to possible violations by firms under inspection. Specifically, the rule requires that if the Board determines that information obtained by the Board's staff during any inspection indicates that the registered public accounting firm subject to such inspection, any associated person thereof, or any other person, may have engaged, or may be engaged in any act, practice, or omission to act that is or may be in violation of the Act, the rules of the Board, any statute or rule administered by the Commission, the firm's own quality control policies, or any professional standard, then the Board shall, if it determines it appropriate, report such possible violations to the Commission

and each appropriate state regulatory authority.[9/] The Board has removed the phrase "subject to the provisions of Section 105(b)(5)(B) of the Act" from Rule 4004(a) because it is the Act, rather than the Board's rules that directs the recipients of this information to maintain such information as confidential and privileged. This change does not mean that information reported under Rule 4004(a) is not covered by Section 105(b)(5)(A) of the Act.

In addition, under Rule 4004, if the Board determines it appropriate, the Board shall commence an investigation of such act, practice, or omission in accordance with Section 105(b) of the Act and the Board's rules thereunder or commence a disciplinary proceeding in accordance with Section 105(c) of the Act and the Board's rules thereunder.

The phrase "if it determines appropriate" in Rule 4004 is meant to signal that the Board will decide which of these acts, practices and omissions would be appropriate to refer to the Commission and to the states or other authorities. In making this determination, depending on the nature of the possible violation, the Board could conclude that it may be appropriate to report information to the

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[9/] As discussed in more detail below in the section-by-section analysis of Rule 4008, the Board has, in order to more closely track the Act, added a definition of "appropriate state regulatory authority" based on the definition of that term in the Act. The Board expects that, in most cases, the appropriate state regulatory authority to receive an inspection report will be any state, agency, board or other authority that has issued a license or certification number authorizing the firm to engage in the business of auditing or accounting.

Commission, and not the states or other authorities, and vice versa. A note to the rule makes clear that the Board may, as appropriate, report information and make referrals to agencies other than those specifically described in Rule 4004.

The Board received a number of comments on proposed Rule 4004. Most of these comments related to the proposed rule's standard for triggering a possible Board report. Several commenters indicated that they believed the threshold of a possible violation was too low. On the other hand, one commenter believed the threshold, as it related to reports to state regulatory authorities, was too high and encouraged the Board to provide such reports to state authorities anytime a possible violation is detected unless the Board determines such a report to be inappropriate. Other commenters urged the Board to use discretion in making referrals generally or as it relates to certain types of possible violations. In particular, several commenters expressed concern about the parallel treatment in the Act and the Board's rules of possible violations of the firm's own quality control policies with possible violations of laws and professional standards.

After considering these comments, the Board has decided not to change the threshold for reports under Rule 4004. The rule tracks Section 104(c) of the Act, which is itself a directive to the Board, and the Board does not consider it appropriate to change the threshold for reporting set forth by Congress in the Act. The Board notes, however, that, as provided for in the Act, Rule 4004 calls for the Board to report such information "if it determines [such a report to be]

appropriate." The Board will exercise judgment in determining when to make reports pursuant to Rule 4004. The Board recognizes that the circumstances calling for a report of a possible violation of a statute or rule administered by the Commission differ significantly from any circumstances in which a report of a possible violation of a firm's own quality control policies would be appropriate.

To clarify the purpose of the note, we have revised it to speak in terms of the Board "report[ing] information" – as the rule does – as well as in terms of "referrals." One commenter asserted that the Note to the rule exceeded the Board's statutory authority and that referrals should be limited to the agencies specifically listed as the required recipients of Board reports in Section 104(c) of the Act. The Board does not believe that its authority to report information or to make referrals is limited in the way suggested by the commenter. While Section 104(c) requires the Board to report such information to the Commission and the appropriate state regulatory authority, other parts of the Act, such as Section 105(b)(5), clearly contemplate that the Board is permitted to make information from its inspections available to other regulatory authorities. Similarly, other parts of the Act, such as Section 105(b)(4), clearly contemplate that the Board is permitted to make referrals to other regulatory authorities.

Another commenter suggested that the Board limit the Note to Rule 4004 to the agencies listed in Section 105(b)(5)(B) of the Act. The Note to the rule is intended to serve a different purpose. The Note is intended to provide notice that

Rule 4004, in implementing Section 104(c) of the Act, should not be understood as precluding the Board from exercising the Board's other statutory authority to make referrals or to report information from inspections. Neither the rule nor the note are intended to describe the limit of that authority.[10/]

Finally, one commenter recommended that the Board provide for notification to the firm when the Board reports information under this rule. In light of the fact that the Board's reports under this rule could, in appropriate circumstances, trigger a law enforcement investigation, the Board does not believe that adding a right to such notification to its rules would be appropriate.

Rule 4005 – Record Retention and Availability

Section 104(e) of the Act provides that the "rules of the Board may require the retention by registered public accounting firms for inspection purposes of records whose retention is not otherwise required by Section 103 or the rules issued thereunder." The Board is reserving this rule in anticipation of issuing

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[10/] Several commenters suggested the Board go further and require agencies receiving reports pursuant to this rule to enter into confidentiality agreements. The Board does not see a need for a rule that requires confidentiality agreements with respect to such reports. The Board intends, however, to take reasonable measures to seek to ensure that the confidentiality requirements of the Act will be honored with respect to confidential information the Board reports to any regulatory or law enforcement authority.

standards on record retention as part of its standard setting process once it has experience with its inspection program.[11/]

One commenter suggested that, when the Board does promulgate record retention standards, they be consistent with the rules of the Commission implementing Section 802 of the Sarbanes-Oxley Act.[12/] The Board will consider this suggestion at the appropriate time. The Board reminds registered public accounting firms that they should continue to comply with all other applicable federal, state and professional record retention requirements.

Rule 4006 – Duty to Cooperate with Inspectors

Rule 4006 requires every registered public accounting firm and every associated person of such firm to cooperate with the Board in any Board inspection. The rule requires that such firms and persons must cooperate and comply with any request, made in furtherance of the Board's authority and responsibilities under the Act, for documents or information. We have revised the rule slightly from the proposed rule. The proposed rule provided that cooperation included providing documents or information "that the Board

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[11/] The Board anticipates that standards concerning record retention will continue to be codified in the standards sections of the Board's rules. Any future Rule 4005 on record retention and availability for inspections will supplement those standards.

[12/] See Securities and Exchange Commission, Retention of Records Relevant to Audits and Reviews, Release No. 34-47241 (Jan. 24, 2003).

considers relevant or material to the subject matter of the inspection." Upon further reflection and upon consideration of the comments generally, we have eliminated that standard, which appears in Section 105 of the Act concerning investigations, and replaced it with the general cooperation standard described in Section 102(b)(3). Like Section 102(b)(3), the rule now describes the required cooperation in terms of cooperating and complying with any request "made in furtherance of the Board's authority and responsibilities under the Act."

Rule 4006 is intended to provide for Board access to documents and information to the full extent authorized by the Act. Among other things, that means that the scope of the rule is not limited to documents and information generated in the course of audits of issuers. Under Section 104(d) of the Act, Board inspections involve evaluations and testing of, among other things, a firm's quality control and supervisory procedures. Accordingly, the documents and information the Board is likely to request as part of its authority and responsibilities to inspect registered public accounting firms, and that therefore a firm must cooperate by providing access to, will involve more than documents and information generated in the course of audits of issuers.

One commenter inquired about the confidentiality of documents provided by firms and associated persons to the Board pursuant to their duty to cooperate with the Board under Rule 4006. The Act provides that, in general, "all documents and information prepared or received by or specifically for the Board,

and deliberations of the Board and its employees and agents, in connection with an inspection under section 104 . . . shall be confidential and privileged as an evidentiary matter (and shall not be subject to civil discovery or other legal process) in any proceeding in any Federal or State court or administrative agency . . . ." Accordingly, documents and information received by the Board pursuant to Rule 4006 in connection with a Section 104 inspection are entitled to this statutory protection.

Another commenter suggested that the Board's staff should have to make a demonstration of its need for copies of documents before making copies of firm documents, rather than just having access to them. The Board has decided not to add this requirement to its rule. While the Board expects to only make and remove copies of documents it needs, it is clear that the Board cannot conduct the type of rigorous inspection program contemplated in the Act without the ready ability to make and remove copies of documents in the possession of registered firms and their associated persons. Adding a "demonstration of need" standard to Rule 4006 could create needless disagreements about whether the Board needs copies of particular documents that might frustrate the Board's compliance with its statutory responsibilities.

Finally, one commenter expressed concern that cooperating with the Board, as provided for in Rule 4006, "presents numerous potential conflicts with state laws and with non-U.S. laws and professional standards." This commenter

therefore recommended that the Board amend the rule to provide that the production of documents and other information covered by the rule is only required to the extent consistent with applicable laws and professional standards. As discussed above in this release, the Board recognizes that its oversight of non-U.S. auditors raises special issues and is committed to finding ways to accomplish the goals of the Act without subjecting non-U.S. firms to conflicting requirements.

In addition, as discussed in more detail in the Board's release adopting its investigation and adjudication rules,[13/] the Board intends to recognize certain privileges recognized elsewhere in the law. As explained in more detail in that release, however, the Board will not honor assertions of an "accountant-client" privilege. More generally, any perceived state law or professional nondisclosure requirements or other obstacles to compliance with an accounting board demand (other than a privilege that would be a valid basis for resisting a Commission subpoena) are, in the Board's view, preempted by the Act. Accordingly, a failure to cooperate with a Board inspection on the basis of such requirements would be a violation of Rule 4006.

[13/] PCAOB Release No. 2003-016, at pages A2-33 - A2-34 (Sept. 29, 2003).

Rule 4007 – Procedures Concerning Draft Inspection Reports

Rule 4007 describes procedures relating to a registered public accounting firm's opportunity to review and comment on a draft inspection report before the Board issues a final inspection report concerning the firm. In the final rules, nonsubstantive changes have been made to more explicitly delineate a distinction between a rule concerning draft inspection reports (Rule 4007) and a rule concerning final inspection reports (Rule 4008). As discussed below, however, we have also made substantive changes to both rules.

Rule 4007(a) provides that the Director of the Division of Registration and Inspections will make a draft report available for review by the firm that is the subject of the report. Paragraph (a) provides that a firm then has 30 days, or such longer period as the Board may order, in which to submit any written response that the firm wishes to submit to the draft. A firm is not required to submit a response, and any response that a firm chooses to submit may include any comments, objections, recommended revisions, or other views on the draft report.

At least one commenter was confused by, and asked the Board to explain, the provisions of the proposed rule that stated that, at the conclusion of each inspection, the Director would submit a draft report to the Board and then, unless the Board directed that transmittal be deferred, transmit the draft report to the firm under review. This part of the rule only described internal Board procedures.

To eliminate any confusion created by this provision and to preserve the Board's flexibility to structure its internal processes, we have deleted these provisions from the rule. Instead, the final rule begins with what had been paragraph (b) of the proposed rule, and we have made certain changes to that paragraph.

One change concerns the amount of time within which the rule requires a firm to submit any response. Commenters suggested that 30 days was too short a period, and that a more appropriate period would be 60 days. We believe that, as a general matter, 30 days allows sufficient time, so we decline to make the suggested change. We have, however, added a provision that would allow the Board to grant a longer period when warranted by unusual circumstances.

Commenters also raised concerns and questions about the confidential nature of the draft report, including the question of the draft report's status under Section 105(b)(5)(A) of the Act. Section 105(b)(5)(A) provides, among other things, that any document prepared by the Board in connection with an inspection "shall be confidential and privileged as an evidentiary matter (and shall not be subject to civil discovery or other legal process) in any proceeding in any Federal or State court or administrative agency . . . ." A draft inspection report is plainly encompassed by that provision. We do not, however, read the Act to prohibit a firm, once in possession of a draft (or final) report, from voluntarily disclosing or providing the report or any portion of it to any other person.

In light of that, we have revised Rule 4007 to implement certain flexibility afforded by the Act. Specifically, proposed Rule 4007 would have provided that the Board would transmit the draft report to the firm. The Act, however, requires only that the Board "provide a procedure for the review of" the draft, and does not require that the Board allow a firm to retain a copy of the draft. The flexibility afforded by the Act would allow the Board to exercise some discretion with respect to whether the sensitivity of certain information is appropriately guarded by not allowing the firm to retain a copy of a portion of the report. To allow for the option of making appropriate use of that flexibility, the rule that we adopt provides that the Board will make a draft report available for a firm's review.

Rule 4007(b) concerns requests that a firm may make for confidential treatment of portions of its response to the draft. The proposed rule addressed this point partially in rule text and partially in a note to the rule. In response to comments, the final rule that we adopt addresses the issue only in rule text. In addition, at a commenter's suggestion, we have added rule text so that the rule more closely tracks certain aspects of the statute.

Rule 4007(b)(1) provides that a firm may request confidential treatment under Section 104(f) of the Act for any portion of the firm's response to the draft report and may supply any supporting authority or other justification for according confidential treatment to the specified information. Rule 4007(b)(2) implements Section 104(f)'s requirement that the Board shall attach to, and make part of, the

inspection report, any response submitted by the firm. Further implementing Section 104(f), Rule 4007(b)(2) provides that the version of the response that becomes part of the inspection report will be redacted to exclude any information for which the firm requested confidential treatment and which it is reasonable to characterize as confidential.

One commenter suggested that the rule should supply some guidelines concerning how the Board will determine what is "reasonable to characterize as confidential." We decline to articulate guidelines to describe categorically what is reasonable to characterize as confidential. Another commenter raised questions about the applicability of Section 105(b)(5)(A)'s confidentiality protection to various documents in the inspection process, including the firm's response to a draft. The Section 105(b)(5)(A) protection described above for documents prepared by the Board in connection with an inspection, extends also to documents "received by" the Board and to documents "prepared . . . specifically for" the Board. The response that a firm provides to the Board falls into both of those categories. The Board will therefore maintain the response as confidential except to the extent that the Act expressly allows or requires the Board to disclose it.[14/]

[14/] As with draft and final inspection reports, nothing in the Act affirmatively prohibits a firm from voluntarily disclosing or providing its response to any other person.

The Act expressly allows or requires the Board to disclose the firm's response in at least three ways. First, Section 104(f) of the Act requires that the text of the firm's response must be attached to and made part of the inspection report. As part of the inspection report, the response will become public if and when the relevant portion of the report becomes public. Second, Section 104(g)(1) of the Act requires that the Board transmit the firm's response to the Commission and to appropriate state regulatory authorities when the Board transmits the final report to them.[15/] Third, Section 105(b)(5)(B) allows the Board to transmit to the regulatory and law enforcement agencies specified there any materials covered by Section 105(b)(5)(A), which would include the firm's response to the draft.

Any confidential treatment that the Board grants pursuant to a firm's request under Section 104(f) would restrict disclosure of the information only in the context of the first of those three possibilities – the inclusion of the response as part of the inspection report. The only consequence of the confidential treatment afforded under Section 104(f) is that the Board will redact the confidential information from the version of the response that is attached to and made part of the inspection report. Accordingly, if the portion of the final report

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[15/] The proposed rules did not explicitly implement this provision of the Act. We have, however, adopted revisions to Rule 4008, discussed below, that implement this provision.

that includes the response eventually becomes public, it will not include any information granted confidential treatment under Section 104(f).[16/] In the second and third contexts described in the preceding paragraph, however, nothing in Section 104(f) operates to limit what the Board may disclose to certain regulatory and law enforcement agencies.

Rule 4007(c) provides that after receiving the firm's response, the Board has various options. The rule permits the Board to take such action with respect to the draft report as it considers appropriate. For example, the Board may adopt the draft report as the final report, revise the draft report, or continue or supplement the inspection before issuing a final report. If the Board directs the staff to continue or supplement the inspection or revise the draft report, the Board may, in its discretion, afford the firm the opportunity to review any revised draft inspection report.

A number of commenters suggested that Rule 4007 should mandate a second review period by the registered firm whenever the Board revises a draft inspection report. Rule 4007(c) permits the Board, in its discretion, to afford firms

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[16/] For example, if the firm's response is directed to the portion of the report that deals with quality control defects, the response will not be made public for as long as that portion of the report is not made public. That portion of the report may be made public, however, if the firm fails to address the criticisms to the Board's satisfaction within 12 months. At that time, that portion of the report, including the firm's response, would be made public, but any part of the response that had received confidential treatment under Section 104(f) would be redacted from the report that is made public.

a second opportunity to comment on an inspection report when the Board continues or supplements its inspection or revises a draft report after receiving a firm response. The Board intends to afford registered firms an opportunity to comment on revised reports when new findings or assessments have been made or, more generally, when significant changes have been made to the draft report by the Board. A mandatory requirement for a second round of review by the firm, however, would mean that the Board would have to go through an additional period of at least 30 days even in those situations where the report was revised just to eliminate assessments that the Board believes should not be in the final report in light of the firm's comments on the draft of the report. A mandatory second round of comment in such situations would be both unnecessary and inefficient.

One commenter suggested the Board allow registered firms a hearing before adopting a final inspection report without incorporated changes suggested by the registered firm after reviewing the draft inspection report. More generally, several commenters suggested that the Board needed to add "due process" to the inspection process. The Act provides sufficient and appropriate process with respect to inspections, and the rules fully implement the process provided by the Act. In addition to at least one mandatory round of review and comment before the Board finalizes an inspection report, registered firms have rights under the Act to seek review by the Commission of aspects of final inspection reports and

of Board determinations that criticisms or defects identified in a final inspection report have not been addressed to the Board's satisfaction within 12 months of the date of the inspection report.

Rule 4008 – Procedures Concerning Final Inspection Reports

Rule 4008 describes procedures related to a final inspection report. Rule 4008(a) provides that the Board will make a final inspection report available for review by the firm that is the subject of the report. Rule 4008(b) provides that the Board will transmit the final report to the Commission, along with any additional letter or comments by the Board or the Board's inspectors and along with the firm's response to any draft of the report. Rule 4008(c) provides that the Board will transmit to each appropriate state regulatory authority, in appropriate detail, the final report, any additional letter or comments by the Board or inspectors, and the firm's response to any draft of the report.

As with the corresponding provision of proposed Rule 4007 concerning draft reports, and for the same reasons discussed there, we have revised Rule 4008 to more closely track the Act. Under the rule, as revised, while the Board will always make the final report available for the firm's review, the Board need not necessarily allow the firm to have and maintain its own copy of the full report.

Section 104(g)(1) of the Act requires that the Board transmit the final report "in appropriate detail, to the Commission and each appropriate State regulatory authority, accompanied by any letter or comments by the Board or the

inspector, and any letter of response from the registered public accounting firm." Rules 4008(b) and 4008(c) implement that provision of the Act. Proposed Rules 4008(b) and 4008(c) did not specifically implement Section 104(g)(1)'s requirement to transmit the firm's response to the draft. The final rule we adopt does implement that requirement.

Commenters had several comments on Rule 4008, as proposed. Several commenters recommended that the Board permit the accounting firm subject to the inspection to review any additional letter or comments by the Board or its inspector or forego making such communications.[17/] The Board has not taken this recommendation and has retained this part of the rule, as proposed.

One commenter noted that the Board's description of the state authorities that would receive the final inspection report under Rule 4008, as proposed, differed slightly from the authorities described in the Act's definition of "appropriate state regulatory authority." In response to this comment, the Board has changed its rule to more closely track the Act. To implement this change, the Board has added a definition of "appropriate state regulatory authority" based on the definition of that term in the Act. The Board expects that, in most cases, the appropriate state regulatory authority to receive an inspection report will be

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17/ One commenter stated that the Board lacks authority to make such communications. Section 104(g)(1) of the Act, however, expressly provides for the Board to provide such a letter or comments to the recipients of the inspection report other than the subject accounting firm.

any state, agency, board or other authority that has issued a license or certification number authorizing the firm to engage in the business of auditing or accounting.

The proposed rule provided that, with respect to final reports transmitted to appropriate state regulatory authorities, the Board could omit from the report "any information the disclosure of which could interfere with any investigation, prosecution, or disciplinary proceeding." One commenter suggested that the Board should consult with state regulators before deciding to omit information for this reason. We have not added such a consultation requirement to the rule. The Act leaves to the Board's discretion the determination of what detail is or is not appropriate for reporting to a state regulator. The rule allows the Board the flexibility to exercise that discretion, including discretion about whether to consult with a state regulator about a possible omission, in light of the circumstances surrounding a particular report.

We have, however, deleted from the rule the provision concerning omitting information from a report. We are concerned that including the provision could give rise unnecessarily to an argument that the reasons specified in the provision are the only grounds on which the Board may omit information when transmitting the final report. The Act gives the Board broader discretion than that, and we have revised the rule to avoid creating any ambiguity on that point.

Finally, one commenter recommended that the Board state expressly that inspection reports provided to an appropriate state regulatory authority are subject to Section 105(b)(5) of the Act and that such status preempts state freedom of information or "open records" acts. A final inspection report is a document prepared by the Board in connection with an inspection, and would therefore generally be covered by Section 105(b)(5)(A)'s confidentiality protection. A final inspection report is also likely to contain substantial information "received by" the Board in connection with an inspection, and that is independently subject to the protection of 105(b)(5)(A), as the Act explicitly notes in Section 104(g)(2).[18/] A final inspection report is also unique, however, in that the Act separately contemplates, in Section 104(g)(2), that at least some portions of it will be publicly available.

The Act plainly does not require that a state regulator maintain the confidentiality of any portion of a final report that becomes publicly available pursuant to Section 104(g)(2). Any other portion of the final report, however, as well as any letter that accompanies the transmittal and any copy of the firm's response to a draft report, are subject to the protection of Section 105(b)(5)(A) and, as a consequence, a state regulator receives them subject to Section 105(b)(5)(B)'s express requirement to maintain them as confidential and

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[18/] See Section 104(g)(2) (noting that disclosure of reports to public is "subject to section 105(b)(5)(A)").

privileged. Moreover, with respect to portions of the final report that address quality control defects, state regulatory authorities are equally bound by Section 104(g)(2)'s command that such portions of the report shall not be made public unless the firm fails to do certain things within 12 months of the report's issuance.[19/] Any otherwise applicable state or local law that conflicts with this requirement or stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress would be preempted.[20/]

Rule 4009 – Firm Response to Quality Control Defects

Consistent with Section 104(g)(2) of the Act, when a final inspection report contains any discussion of criticisms of, or potential defects in, the firm's quality control systems, Rule 4009(a) permits the firm to submit evidence or otherwise to demonstrate to the Director of the Division of Registration and Inspections that it has improved such quality control systems, and remedied such defects.[21/] This

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[19/] As noted in the discussion of Rule 4007, however, the Act does not prohibit a firm from voluntarily disclosing or providing a report or any portion of a report to any person.

[20/] See Crosby v. National Foreign Trade Council, 530 U.S. 363, 372-73 (2000); City of New York v. FCC, 486 U.S. 57, 64 (1988).

[21/] As proposed, Rule 4009(a) referred only to the firm under inspection submitting evidence to the Board's staff within 12 months after the issuance of the final inspection report. The Board has changed the rule to refer to the firm "submit[ting] evidence or otherwise demonstrat[ing]" that it has improved its systems or remedied such defects. This change is intended to make clear that the Board's staff may need to conduct more than a "desk review" to determine whether to recommend to the Board that the firm has satisfactorily

submission or demonstration must be made no later than 12 months after the issuance of the Board's final inspection report. The rule requires the Director, after reviewing the evidence, to advise the firm whether he or she will recommend to the Board that the firm has satisfactorily addressed the criticisms or defects in the quality control system of the firm identified in the final inspection report and, if not, why not.

Rule 4009(b) has been added in response to a comment. Rule 4009(b) provides that if the Board determines that the firm has satisfactorily addressed all quality control defects and criticisms in the final report, the Board will promptly provide notice of that determination to the Commission and to any appropriate state regulatory authority to which the Board had provided any portion of the final inspection report.

Rule 4009(c) requires the Board to notify the firm of its final determination as to whether the firm has addressed to the satisfaction of the Board the criticisms or defects in the firm's quality control system.

Rule 4009(d) provides that the Board will make public those portions of a final inspection report dealing with such criticisms and defects if the firm fails to address those matters to the Board's satisfaction within 12 months of the issuance of the final inspection report. Rule 4009(d) specifically addresses the

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addressed the criticisms or defects in the quality control system of the firm identified in the final inspection report.

time of any such public disclosure. Under Rule 4009(d), if a firm made no submission to the Board under Rule 4009(a) concerning the firm's efforts to address the criticisms or potential defects, then the Board would make those portions of the report public upon the expiration of the 12-month period. If the firm made a submission under Rule 4009(a), but then failed to seek Commission review of an adverse Board determination concerning that submission within the time allowed to seek such review, the Board would make those portions of the report public upon the expiration of the period allowed for seeking Commission review. If the firm did timely seek Commission review, under Section 104(h)(1)(B) of the Act, of an adverse Board determination, the Board would make those portions of the report public 30 days after the firm formally requested Commission review, unless the Commission, by rule or order, directs otherwise. The Board is adopting a 30-day delay, subject to any superseding Commission rule or order, to allow the Commission an opportunity to consider whether to order a longer stay of public disclosure in a particular case, since the Act does not operate to stay such disclosure.[22/]

Commenters suggested a number of changes to Rule 4009. One commenter stated that the rule was "too lenient" in allowing the firm under

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[22/] The Board has extended this period from 15 days to 30 days in response to several comments that expressed the opinion that the 15-day period provided for in Rule 4009(d)(3), as proposed, was too short.

inspection 12 months to submit evidence that it has improved its systems or remedied the defects identified in the final inspection report. Another commenter thought the 12-month period was appropriate, but recommended that the rule reflect that some deficiencies may need to be corrected in a shorter time period. The 12-month time period is explicitly provided for in the Act as the period during which the firm must improve its quality control systems or remedy defects in those systems for those portions of a final inspection report dealing with such criticisms or defects to remain non-public. The time period, of course, does not limit a firm from improving its systems or remedying such defects sooner, nor does it limit the Board or its staff from using its authority to direct any appropriate remedial action.

Another commenter recommended that the Board define the terms "criticisms" or "potential defects" as used in this rule. The Board believes the terms, which are used without definition in the Act, are self-explanatory and has decided not to define them. The same commenter, joined by several other commenters, recommended that the Board establish a formal process for a registered public accounting firm to respond to notification of the firm by the Director of the Division of Registration and Inspection of his or her recommendation under Rule 4009(a). (One commenter suggested the firm should be allowed a hearing in cases where there is uncertainty about whether the firm has made the improvements or remedied the defects identified.) In light

of the multiple steps of review and comment already built in to the Board's inspection process, the Board does not believe that it needs to establish an additional, formal mechanism for a response at this point in the process. The Board notes, however, that Rule 4009(a)'s requirement that the Director notify the firm of his or her recommendation will, in the event of a recommendation adverse to the firm, provide a practical opportunity for the firm to come forward quickly with any additional evidence or demonstration that it has in fact improved its systems or remedied the identified defects. Rule 4009(c) provides for the firm to be notified of the Board's final determination and, under Section 104(h)(1)(B) of the Act, a firm that continues to disagree with the Board's determination may seek review of that determination by the Commission.[23/]

Another commenter asked that the Board clarify what date serves as the date of "issuance" of an inspection report under Rule 4009(a). The date of issuance will be the date the final inspection report is adopted by the Board as

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[23/] More generally, several commenters suggested that the rules should provide more procedural specificity and procedural protection. We have not changed the rules in response to those comments. As described above, the Board's inspection rules implement the substantial statutory opportunities for review and comment provided for in the Act. In addition, the Board notes that Section 104(h) of the Act provides an opportunity for registered public accounting firms to seek Commission review of both certain aspects of final inspection reports and final determinations of the Board under Rule 4009(b) with which they disagree. Moreover, the inspection process authorized by the Act and implemented by these rules affords at least as much process as is afforded in comparable inspections and examinations conducted by other authorities, such as the Commission and self-regulatory organizations.

final. Absent extraordinary circumstances, the report will be available for review by the firm beginning on that date.

Finally, one commenter suggested that the Board notify the Commission and each appropriate state regulatory authority to which the final inspection report was provided under Rule 4008(b) and (c) of its final determination concerning whether the firm has addressed the criticisms or defects in the quality control system of the firm identified in the inspection report to the satisfaction of the Board. The Board agrees and has implemented this suggestion by adding paragraph (b) to Rule 4009.

Rule 4010 – Board Public Reports

Rule 4010 permits the Board, at any time, to publish public summaries, compilations, or other general reports concerning the procedures, findings, and results of its various inspections as the Board deems appropriate. The rule allows for these reports to include discussion of criticisms of, or potential defects in, quality control systems of any firm or firms that were the subject of a Board inspection. However, the rule prohibits these published reports from identifying the firm or firms to which these criticisms relate, or at which the defects were found, unless the information has previously been made public pursuant to the Board's rules or other lawful means.

The Board received a few comments on Rule 4010. Several commenters expressed concern that public reports under Rule 4010 not indirectly indicate the

firm or firms involved. The Board agrees and does not intend to issue public reports in a manner that identifies the firm or firms involved, directly or indirectly. Another commenter asked the Board to clarify what is meant by "other lawful means" at the end of Rule 4010. This phrase is meant to address situations in which the covered information is made public by lawful means provided for in the Act. One commenter suggested that the rule indicate that the Board will issue public reports on best practices and positive trends. The Board anticipates that its practice will be to issue such reports in appropriate circumstances, but does not believe its rule needs to be changed to permit this type of report to be issued.

Finally, one commenter expressed concern that Rule 4010 did not adequately protect confidentiality concerns. In issuing public reports under this rule, the Board does not intend to identify, directly or indirectly, the firm or firms involved. Moreover, consistent with one of the provisions of Section 104(g)(2) of the Act, the Board in issuing such reports will protect such confidential and proprietary information as the Board may determine to be appropriate or as may be required by law. Rule 4010 does not implement Section 104(g)(2) of the Act, however, and the Board is not bound by the specific confidentiality provisions of that section of the Act in issuing these general reports. Since the point of these reports is, when appropriate, to alert the investing public to relevant inspection-related information that would not otherwise be available, maintaining the

confidentiality of these reports to the same degree that is required for reports that identify specific firms and issuers would defeat the purpose of the report.

Other Comments

In the release that accompanied the proposed rules, the Board noted that "[t]he proposed rules govern procedural matters concerning the Board's inspection program. Board staff will carry out particular inspections according to detailed, nonpublic inspection plans."[24/] Some commenters offered suggestions that pertain to the details of carrying out inspections and other aspects of how the Board should conduct its inspection program, rather than to the procedural issues that these rules address. Rather than address all such comments here, we reiterate the general point that the Board will carry out inspections according to inspection plans that are nonpublic and not available to the firms being inspected. The confidentiality of this aspect of the inspection process is important to the effectiveness of the process from the standpoint of the public interest and the protection of investors. In addition, we recognize that commenters made other valuable suggestions about the conduct of the Board's inspection program that the Board and its staff will consider as they continue to develop that program.

[24/] PCAOB Release No. 2003-013 (July 28, 2003) at 4.