Center for Public Company Audit Firms
Committed to Audit Quality

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April 15, 2004

Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Re: File No. PCAOB-2003-07

Members and Staff of the Commission:

The Center for Public Company Audit Firms of the American Institute of Certified Public Accountants ("AICPA") respectfully submits the following written comments on the proposed rules the Public Company Accounting Oversight Board (the "Board" or the "PCAOB") has filed with the Securities and Exchange Commission (the "SEC" or the "Commission") regarding investigations and adjudications. The Center was established by the AICPA to, among other things, provide a focal point of commitment to the quality of public company audits and provide the Commission and the PCAOB, when appropriate, with comments on its proposals on behalf of Center member 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 recognizes the enormous effort put forth by the Commission and PCAOB members and staff to implement the provisions of the Sarbanes-Oxley Act of 2002 (the "Act"). A cornerstone of the Act was the grant of authority to the PCAOB to investigate and discipline registered public accounting firms and associated persons of such firms for violations of the Act, rules of the Board, provisions of the federal securities laws relating to the preparation and issuance of audit reports, and professional standards. The AICPA is committed to working with the Commission and the PCAOB to develop a fair and effective process to implement the Board's authority to investigate and discipline registered public accounting firms. To that end, the AICPA appreciates the opportunity to comment on the proposed rules regarding investigations and adjudications.

Overall, the AICPA recognizes that changes made in the PCAOB final rules were responsive to certain comments submitted and sees the importance of finalizing the rules on investigations and adjudications to enable the PCAOB's program to become operational. We believe, however, that the proposed rules should be clarified and improved in several important respects and cannot overemphasize the importance of clear, concise and understandable rules to the hundreds of firms and thousands of practitioners that will be affected by these rules. Accordingly, we offer the following comments:

Proposed Rule 5102(c) – Use of Non-lawyer Technical Experts in Testimony

Proposed rule 5102(c) would address the conduct of oral testimony during Board investigations. Under proposed rule 5102(c)(3), a witness may be represented by counsel. In addition, "such other persons" as the Board or the Board's staff "determine are appropriate to permit to be present" could attend the examination. It is unclear from this language whether, under this standard, an accountant or other non-lawyer technical expert retained by an attorney to assist in the lawyer's representation of a witness generally would be allowed to attend the witness's examination.

In the context of SEC proceedings, courts have recognized this right, and we believe that the Board's rules should do so as well. Specifically, in *SEC v. Whitman,* 613 F. Supp. 48 (D.D.C. 1985), the court held that a witness subpoenaed to give testimony in an investigation was entitled to representation by counsel who was assisted by a non-lawyer whose presence served to bridge the gap between the technical expertise of the witness's lawyer and the staff personnel questioning the witness. Accordingly, the court concluded that, to the extent that the SEC's Rules of Practice were construed to preclude the attendance of the non-lawyer adviser at the client's testimony, they inappropriately interfered with the client's right to effective counsel. The attendance of accounting and technical experts at testimony taken by the Commission's staff is now common, has not proven disruptive, and allows counsel to represent witnesses effectively (as noted by the *Whitman* court). We urge the Commission to avoid any similar ambiguity in the Board's rules by expressly providing that a non-lawyer technical expert may attend a witness's examination where the expert has been retained to assist the lawyer in the representation of the lawyer's client, so long as the expert in question has not been or is not reasonably likely to be separately examined during the Board's investigation.

Proposed Rule 5106 – Assertion of Claim of Privilege

Proposed rule 5106 requires a significant amount of information to be supplied in order to substantiate a privilege claim. As currently drafted, the proposed rule suggests that the failure to provide *each* of these items could subject a registered public accounting firm to a disciplinary action and sanctions for failing to cooperate with an investigation, even if the omitted information (*e.g.,* the precise date of a communication, or the identification of the place where it occurred) was not critical or necessary to assessing the good faith of a privilege claim or the information was not in the possession, or within the knowledge, of the party asserting the privilege. Moreover, the Board's assertion in its adopting release that "the information required [to substantiate a privilege assertion] will necessarily be readily available to the person asserting the privilege" seems circular. The Commission should consider revising the proposed rule to acknowledge clearly that a failure to cooperate proceeding will not be instituted against a party for failing to provide information pursuant to proposed rule 5106, absent a showing that (1) the information is readily available, and (2) the information is necessary to assess the good faith of a privilege claim.

Proposed Rule 5109(a) – Review of Order of Formal Investigation

Proposed rule 5109(a) is adapted from the SEC's Rules of Practice and provides that the Director of Enforcement and Investigations may authorize the release of a formal order of investigation to a requesting party. Consistent with SEC practice, the proposed rule should expressly authorize the Director of Enforcement and Investigations to delegate this authority to other members of his or her staff. Otherwise, requesting parties may experience extensive and unnecessary delays in obtaining access to formal orders.

Proposed Rule 5109(d) – Statements of Position

Proposed rule 5109(d) states that, in its discretion, the Board's staff "may advise [persons who become involved in an informal or formal Board investigation] of the general nature of the investigation, including the indicated violations as they pertain to those persons and the amount of time that may be available for preparing and submitting a statement prior to the presentation of a staff recommendation to the Board." We recognize that the Board's proposed rule is adapted from the SEC's "Wells Submission" process. Accordingly, we looked back at the genesis of the Commission's rule and believe that the process that the PCAOB proposes to apply to its investigations (as well as the Commission's current rule) should be revised.

The critical flaw in the Board's proposed rule is that it does not require the Board to provide a registered public accounting firm or its associated persons with a meaningful opportunity to submit their positions to the Board. As drafted, the proposed rule permits persons who become involved in formal and informal investigations to submit written statements setting forth their positions, but does not *require* the Board's staff to advise such persons of the specific nature of the contemplated allegations or the available time in which to make such submissions. In 1972, then-SEC Chairman William J. Casey appointed a committee (chaired by John Wells and commonly referred to as the "Wells Committee") to review and evaluate the Commission's enforcement policies and practices. Among the recommendations made by the Wells Committee was the following:

> Except where the nature of the case precludes, a prospective defendant or respondent should be notified of the substance of the staff's charges and probable recommendations in advance of the submission of the staff memorandum to the Commission recommending the commencement of an enforcement action and be accorded an opportunity to submit a written statement to the staff to be forwarded to the Commission together with the staff memorandum.

Clearly, the Wells Committee believed that notice and opportunity to submit a written statement to be forwarded to the Commission along with the staff's recommendation was extremely important and that potential respondents should be deprived of this opportunity only "where the nature of the case precludes" (*e.g.,* where exigent circumstances require immediate action). We recognize that the Commission implemented a rule that was not as strict — and not as protective of prospective respondents' rights — as the one recommended by the Wells Committee. We believe, however, that the Board's proposed rule would be (1) inefficient because key points of fact or law might not be provided to the Board for its consideration, (2) inequitable because potential respondents in similar situations could be treated differently depending on the discretion of the Board's staff, and (3) unfair because accounting firms and their associated persons could be the subject of disciplinary proceedings — an event that may trigger disclosure to clients as well as state regulators — without a meaningful opportunity to state their positions before the Board. Moreover, we cannot fathom why the Board would not want to consider potential respondents' fully-informed positions at the time it is making such important decisions.

Accordingly, we believe that the proposed rule should be revised to expressly afford prospective respondents with the opportunity to make meaningful pre-hearing submissions [with the exception of rare cases that involve extreme circumstances,] by providing that (1) [with the exception of cases presenting exigent circumstances,] prospective respondents shall be notified of the staff's charges and probable recommendations in advance of the submission of the staff's memorandum to the Board, (2) prospective respondents shall be granted a reasonable period of time to prepare a submission, and (3) any statement submitted by a prospective respondent shall be submitted to the Board together with the staff's memorandum.

In addition, we believe the proposed rules would be enhanced by providing persons subject to an investigation with access to materials described in proposed rule 5422(a) at the point when the Board's staff determines to recommend that the Board institute a disciplinary proceeding. Providing persons under investigation with a clearer picture of the information to be presented to the Board would (1) facilitate meaningful submissions more directly addressing the issues the Board would be considering and (2) promote the more efficient resolution of matters because relevant evidence would be shared earlier in the process. In our view, these recommendations will assure maximum fairness to persons subject to these rules, without compromising the Board's need for effective and timely enforcement.

Proposed Rule 5200(a)(2) - Supervisory Personnel

Proposed rule 5200(a)(2) implements Section 105(c)(6)(A) of the Act and provides that the Board may commence disciplinary proceedings when it appears that a registered public accounting firm, or its "supervisory personnel," has failed reasonably to supervise an associated person of the firm. The proposed rule would introduce a new basis upon which to sanction accountants, modeled after a provision of the Securities Exchange Act of 1934 (the "Exchange Act") governing the regulation of broker-dealers. Neither the Board's proposed rules nor the accompanying section-by-section analysis, however, provide a definition of, or any guidance for interpreting, the term "supervisory personnel."

In the context of Section 15(b)(4)(E) of the Exchange Act, there are many cases interpreting what it means to be "subject to" a broker-dealer's supervision. These cases address the potential liability of broker-dealer personnel ranging from "line" supervisors to legal and compliance officers and demonstrate the difficulty often involved in determining whether an individual is a supervisor under the statute. In addition, in reaction to both the statutory liabilities under the Exchange Act and various case-law developments, supervisory structures of brokerage firms have evolved over an extended period of time.

In comparison, "failure to supervise" liability is an essentially new concept for the accounting profession, as is the statutory "safe harbor" defense under Section 105(c)(6)(B) for avoiding such liability where a firm has procedures in place "reasonably designed" to prevent and detect violations of applicable standards by associated persons of the firm and the supervisor of such persons had no reasonable cause to believe that the firm's procedures and systems were not being complied with. In its adopting release, the PCAOB itself acknowledged that the proposed rule raised legitimate concerns and that it would continue to consider whether to provide additional clarification. Under these circumstances, the AICPA respectfully submits that the appropriate approach would be to refrain from adopting a rule that subjects "supervisory personnel" to a range of sanctions based on an undeveloped and ambiguous failure to supervise standard until the Board provides, preferably through a separate rulemaking, clear definitions as to the meaning of the term "supervisory personnel" for purposes of the Board's rules, as well as practical guidance as to when the safe-harbor provisions set forth in Section 105(c)(6)(B) of the Act generally would be deemed satisfied. Absent such additional guidance, both firms and their personnel will be left uncertain as to their responsibilities and potential liabilities under the Board's rules.

Proposed Rule 5300 – Standard Applicable to Imposition of Sanctions

Proposed rule 5300 sets forth the sanctions that the Board may impose as a result of a disciplinary proceeding. Section 105(c)(5) of the Act makes clear that certain sanctions may only be imposed in cases of (1) intentional or knowing conduct or (2) repeated instances of negligence. The proposed rule, however, does not articulate a standard that must be met in order to impose any other sanction on a registered public accounting firm or associated person thereof. We believe that the Board should establish clear standards applicable to the imposition of any sanction. Accordingly, except for those sanctions referenced in Section 105(c)(5) of the Act, we recommend that the Commission direct the Board to adopt the standard articulated

in Rule 102(e) of the SEC's Rules of Practice and that the proposed rule expressly provide that sanctions may be imposed by the Board only upon a showing that a registered firm or associated person engaged in the types of conduct identified in Rule 102(e). The proposed rule directly impacts an accountant's ability to practice and we see no reason for the Board to depart from the standards established by the SEC for imposing similar sanctions.

Proposed Rule 5301 – Effect of Sanctions

Proposed rules 5301(a) and (b) would prohibit any person who is subject to a Board suspension or bar from becoming or remaining associated with any registered public accounting firm. As defined in Section 1001(p)(i), a "person associated with a public accounting firm" is any person who "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." In short, an associated person is any person who works on, or receives compensation from work performed on, audits of public companies (or "issuers").

We believe that the practical application of the proposed rule, as drafted, is unclear and potentially unfair. Accordingly, in order to assist registered public accounting firms in deciding whether there are circumstances in which they might reasonably continue to employ a suspended or barred person, the proposed rule should be revised to clarify the nature of the work such persons may perform and the payments such persons may receive from the firm.

The proposed rule and PCOAB commentary indicate that a suspended or barred person may continue to work for a registered public accounting firm, if the nature of his or her work does not relate to an "issuer" (*e.g.,* he or she engages in activities that an unregistered public accounting firm could undertake). We agree with this conclusion. However, it is unclear precisely how a firm could compensate the suspended or barred person for such work.

The confusion flows from the statutory and regulatory definition of "associated person of a registered public accounting firm." In particular, neither the proposed rule nor the adopting release sheds any light on what it means to share in the profits or receive compensation "in connection with the preparation or issuance of any audit report." Although a firm may be able to identify and segregate bonuses or profit sharing units that directly relate to a particular audit engagement, it is not clear whether a firm can identify all compensation potentially received "in connection with" audit fees.

We agree that a suspended or barred person should not receive compensation that he or she would have earned for performing work on a public company audit or for securing a public audit engagement. It is not clear, however, whether the proposed rule also contemplates that registered public accounting firms would be required to segregate public and private audit work fees and then attempt to trace all compensation paid to a suspended or barred person to particular fees. For example, in a hypothetical situation where a firm earned $50 from public audit work and $50 from non-audit work and paid a suspended or barred person $10, where would the $10 come from? Because money is fungible, it is virtually impossible to demonstrate the origin of every dollar of compensation paid to employees. Accounting firms generally do not classify salary and other forms of regular compensation (*e.g.,* payments other than bonuses or special compensation tied to individual performance) as having been derived from any particular fee. In addition, compensation is often tied, at least in part, to the overall performance of the firm, including fees derived from both public and private audit work. We appreciate that the PCAOB's adopting release notes that the proposed rule "does not mean that a salaried employee must suffer a salary cut that mirrors the portion of the firm's profits that are from audit work." The release, however, does not provide sufficient guidance as to what the proposed rule does mean (*i.e.,* what payments are permissible and how are such payments to be calculated). Indeed, even a salaried

employee gets a share of a firm's overall revenues, in a sense, because the employee is compensated out of a firm's available cash.

We strongly believe that for this rule to have any meaning in practice, there must be a clear statement regarding how a suspended or barred person could be compensated. The proposed rule should, at a minimum, clarify that a suspended or barred person may remain an employee of a registered public accounting firm so long as that person does not participate in audits of public companies, and that he or she may be compensated from the general revenues of the firm. Without this clarification, there is no way to know how a suspended or barred person may be safely compensated by a registered public accounting firm. Without clarification, the proposed rule will have the unintended consequence of causing registered public accounting firms to immediately terminate any suspended or barred person (regardless of the nature of the work such person would perform going forward) rather than risk running afoul of this impenetrable provision and subjecting the firm to sanctions for improperly continuing an associated person relationship.

Expedited Timetable in Non-Cooperation Proceedings

The proposed rules include several provisions that expedite the timetable applicable to various filings in non-cooperation proceedings instituted by the Board under Rule 5200(a)(3), compared to the applicable timing for similar filings in proceedings instituted under Rules 5200(a)(1) and (2). For example, respondents in Rule 5200(a)(3) proceedings would be required to comply with shorter time periods (1) to file answers pursuant to Rule 5421(b), (2) to file post-hearing briefs pursuant to Rule 5445(a) and (b), and (3) to file petitions for review of initial hearing officer decisions under Rule 5460(a)(2). Similarly, hearing officers in Rule 5200(a)(3) proceedings would be required to comply with shorter time periods to prepare initial decisions under Rule 5204(a) and interested divisions would be required to comply with shorter time periods in which to commence making documents available to respondents pursuant to Rule 5422(c).

The Board's rationale for expedited time periods applicable to Rule 5200(a)(3) proceedings is not clear to us. The Board may believe that it will be a simple matter to gather and review the facts relevant to an assessment of a respondent's cooperation. Alternatively, the Board may be assuming that a respondent in a Rule 5200(a)(3) proceeding is, in fact, not cooperating with the Board and should be afforded only a limited amount of time to defend the Board's allegations of non-cooperation, or that the prospect of non-cooperation poses a potential threat to the Board's processes that demands a quick resolution. Regardless of the Board's assumption, however, many situations may arise where there is a good-faith difference of opinion as to whether the respondent has cooperated with the Board and there is no reason to assume, as a matter of course, that answers and other materials filed in these proceedings can be prepared more quickly than similar materials in other types of Board proceedings. Moreover, attempting to pursue a complex case involving a non-cooperation allegation under an expedited timetable may impinge on a respondent's ability to receive effective assistance from counsel. Whether or not a firm or individual has cooperated is an issue of fact and we believe that respondents in such proceedings should be treated equitably under the proposed rules and, in particular, have an opportunity to prepare filings and submissions under the same timetable as any other respondent.

Proposed Rule 5467(b) - Receipt of Petitions for Commission or Judicial Review

Proposed rule 5467(b) would require a registered public accounting firm to file with the Board a notice and copy of any petition for Commission or judicial review of a final disciplinary sanction filed by an associated person of the registered public accounting firm. We believe that the proposed rule is superfluous to existing procedural rules. Specifically, in the context of petitions for Commission review, Rule 420 of the SEC's Rules of Practice provides that an application for review filed by a person aggrieved by a self-regulatory organization determination must be served by the applicant on the self-regulatory organization. In addition,

in the context of petitions for appellate court review of agency orders, Rule 15(c) of the Federal Rules of Appellate Procedure provides that petitioner must serve a copy of the petition on each party admitted to participate in the agency proceedings. Accordingly, the Board will receive a notice and copy of any filed petitions pursuant to existing procedural rules.

Moreover, to the extent that the Commission believes that an additional filing obligation is necessary to ensure that the Board receives a notice and copy of a petition, we believe that the appropriate approach would be to impose any such duty on the party seeking review (in this situation, the associated person), rather than such person's employer, a non-party to the proceeding who, among those with an interest in the proceedings, would be least likely to be able to discharge that burden. In addition, we believe that the proposed rules should be revised to require an associated person to provide a notice and copy of any petition to his or her firm, so that the firm is afforded appropriate notice and opportunity to determine whether it should make a separate submission.

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The AICPA appreciates the opportunity to provide comments on the proposed rules. We are firmly committed to working with the SEC and PCAOB in accomplishing the timely and effective implementation of the Act and again want to reiterate the importance of issuing clear, concise and understandable rules to the firms and practitioners that will be affected by these rules. We would welcome the opportunity to meet with you to clarify any of our recommendations.

Sincerely,

Robert J. Kueppers
Chair
Center for Public Company Audit Firms

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