March 31, 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. 001**

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 registration system for 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. For more than twenty years, the Section has imposed various membership requirements to help assure that SEC registrants are audited by member firms with effective quality control systems. 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 will be required to register with and follow the rules of the Board. 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 proposed rules of the Board's registration system. However, the SECPS considers it unfortunate that the timing and brevity of the comment period may not allow sufficient time for many of the Section's member firms to adequately comment on the proposed rules. The majority of the Section's member firms have been concurrently involved in reviewing their SEC clients' Forms 10-K, many of which have the same deadline as the Board's comment period on its proposed rules.

Overall, the SECPS supports the proposed rule regarding the PCAOB's registration system. However, we believe that the rule could be clarified and improved in several respects and offer general comments as well as more specific comments pertaining to the proposed rules of the Board and the proposed application form. Our comments are as follows:

## GENERAL COMMENTS

Need for Flexibility in Initial Registration

Complying with the proposed reporting requirements will be challenging for member firms of the Section. Registering with the Board is a new undertaking for public accounting firms, few of which, if any, have previously sought to compile much of the information that would be required under the proposal. We believe it is consistent with the public interest and the Act for the Board to facilitate registration by adopting a system that is initially as flexible as possible, and transitions over time to more definitive requirements. During this transition period, applicants would be able to develop processes and procedures necessary to complete information in a more consistent format. Flexibility during the transition period is extremely important in light of the tight deadlines applicants will have to prepare their registration forms. Failure for firms to meet such tight and difficult deadlines would have catastrophic effects on firms and their public company clients.

Need to Consider Confidentiality and Privacy Issues

The Board's proposed rules would require applicants to provide the social security numbers of their accountants, as well as information about legal proceedings involving certain personnel. Applicants would also be required to disclose information about their clients and the fees billed for services provided to those clients. The Board should address these issues by stating clearly its view of its authority to require such disclosures or by otherwise tempering such requirements by only demanding such information "to the extent permitted by law." With respect to social security numbers, we suggest the Board require applicants use the accountant's CPA license number or some other numerical identifier in order to protect the individual's privacy.

Need to Establish Due Process Procedures

The Board's proposed rules, in certain areas, do not provide for due process procedures whereby a firm can challenge a ruling by the Board to not deny an application or to deny confidential treatment. We believe that the Board should establish formal, fair procedures for applicants to seek and obtain review of a disapproval decision.

## SPECIFIC COMMENTS PERTAINING TO THE PROPOSED RULES OF THE BOARD

Rule 1001 - Definitions of Terms

- *Accountant* – For purposes of firm registration with the PCAOB, the definition of accountant appears overly broad. For example, it includes any accountant who possesses either an undergraduate or higher degree in accounting, regardless of whether such person provides audit or other professional services to an issuer audit client. We believe the definition should be limited to certified public accountants who have the authority to sign a firm's name to an audit opinion. This would limit the definition of "accountant" to audit partners, and prevent firms from having to supply information about hundreds or even thousands of individuals who, although licensed or certified, are not empowered to bind

the firm by signing an audit opinion. Additionally, it would prevent firms from having to continually update such listing because of frequent staff turnover. We understand the need to obtain information about accountants through the Board's inspection and discipline activities, and believe that registered firms should provide that information to the Board as needed, but consider the costs to outweigh the benefits in requiring this information in a firm's registration form.

If the Board retains the definition of "accountant" as currently drafted, the SECPS recommends that the Board clarify what is meant by "participate" in an audit in Rule 1001(a)(3)(ii). The language is vague and the Board should provide clear guidance to accounting firms.

- *Associated Entity* - In the Section-by-Section Analysis, the PCAOB indicates that the definition of associated entity is meant to give the same meaning as in the Commission's auditor independence rules. However, the term "associated entity" is not defined in either Regulation S-X or the Commission's independence rules. The Board should define the term without reference to the Commission's rules. The SECPS recommends that the term be defined as an entity domiciled inside or outside of the United States and its territories that is a member of or similarly connected with an international firm or association of firms with which the applicant holds itself out as being associated.

- *Audit Report* – The definition of "audit report", as drafted, broadly includes any "document or other record" that is "prepared following an audit…in which a public accounting firm…sets forth the opinion of that firm regarding a financial statement, report or other document." We believe that this definition will be confusing to applicants and should be refined to encompass only those audit reports that express an opinion on an issuer's financial statements, and are then made public.

- *Persons Associated with a Public Accounting Firm* – The term "persons associated with a public accounting firm" is overly broad, and we recommend that the PCAOB narrow and clarify the definition, as the SEC has done in analogous circumstances. The proposed definition covers any individual who is a proprietor, partner, shareholder, principal, accountant or professional employee of an accounting firm, as well as any independent contractor or entity that, in connection with the preparation or issuance of an audit report, shares in the firm's profits, receives compensation from the firm, or participates as an agent or otherwise on the firm's behalf in any activity. The Section-by-Section analysis states however that "an employment or an independent contractor relationship with a public accounting firm is not required for a person to be covered by the definition." The definition of "persons associated with a public accounting firm" would be particularly burdensome for accounting firms in the context of Part V of proposed Form 1, which requires applicants to provide information about associated persons that are defendants or respondents in criminal actions, governmental and private civil actions, and administrative and disciplinary actions, involving conduct in connection with an audit report. It would also be onerous in the context of Part VIII of proposed Form 1, which would require

applicants to obtain, within 45 days of submitting an application for registration to the Board, signed consents from all of the applicant's associated persons.

We believe that the definition of "persons associated with a public accounting firm" should be narrowed and clarified. Accordingly, we urge the Board to specify that the term "persons associated with a public accounting firm" extend only to individual proprietors, shareholders, principals, accountants, professional employees, and independent contractors and entities, whose work for the accounting firm has some meaningful relationship to auditing, accounting and reporting issues that affect issuer financial statement preparation. With respect to independent contractors and entities, we suggest that a materiality standard be incorporated into the definition. Such a standard could be based on the relative contribution of the contractor to the overall audit effort in terms of hours or fees. In addition, we urge the Board to exercise its exemptive authority under Section 2(a)(9) of the Act to exempt persons that are "engaged only in ministerial tasks."

- *Plays a Substantial Role in the Preparation or Furnishing of an Audit Report* – The term should be clarified to establish that the phrase does not include non-audit services, including internal audit services, provided to non-audit clients. This could be achieved by limiting the "services" that are considered in calculating whether a firm has performed "material services" that an issuer's principal accountant "uses or relies on in issuing all or part of its audit report with respect to any issuer" to audit services only. In the absence of such clarification, any number of firms that have no relationship to the accounting profession could be subject to the Board's registration requirements. The "plays a substantial role" definition is also implicated by the Item 2.4 fee disclosure requirements.

  In addition, because of the provisions of the proposed rules, there appears to be an unintended consequence that would result in requiring firms to register with the Board that would otherwise have no intent or need to do so. For instance, firms that perform procedures such as routine observations of inventory test counts might be required to register with the Board because the inventory test counts were performed for a subsidiary or component of an issuer the assets or revenues of which constitute 20% or more of the consolidated assets or revenues of such issuer. We encourage the Board to revisit this area so that such firms would not be required to register with the PCAOB.

  It is also unclear whether firms would have to register when they are performing work for a primary auditor and individually the firms do not meet the 20% materiality threshold in terms of engagement hours or fees, but exceed the threshold in the aggregate. The Section recommends that the materiality test should only be applied on a firm-by-firm basis.

Rule 2100 – Registration Requirements for Public Accounting Firms

The proposed rule imposes the requirement of registering with the Board on each public accounting firm that "prepares or issues any audit report with respect to any issuer" or "plays a substantial role" in the preparation or furnishing of such a report. This could be read to require registration of firms that have issued audit reports for issuers covering prior periods, but that do not currently have, and do not expect to have, an engagement with an issuer to prepare or issue, or play a substantial role in the preparation or issuance of, an audit report. We recommend that Rule 2100 be clarified, or an exemption created, to establish that the issuance of an audit report prior to October 24, 2003 (the expected deadline for registering with the Board) does not trigger the registration provisions.

In addition, it is unclear whether a firm that issued an audit report that is included in an initial public offering would be required to register with the Board, even though the firm is not serving as primary auditor-of-record and does not currently have, and does not expect to have, an engagement with an issuer. We recommend that an exemption be created so that such firms would not be required to register with and be subject to the rules of the Board.

Rule 2101 – Application for Registration

The rule, as proposed, requires applicants to file their applications and exhibits thereto electronically with the Board through the Board's web-based registration system. Although firms will not be registered by the Board until the application has been accepted, it is unclear whether firms' applications will be publicly available from the time the application is submitted. The Section recommends that the application, excluding confidential information, only become public when a firm is officially registered with the Board.

Additionally, the Board should consider how functional the registration system will be and how much technological understanding applicants must possess to complete their submissions effectively. As firms proceed through the application process, technical questions will undoubtedly arise. The Board should consider instituting a dedicated help-line to respond to technology-based questions.

Rule 2103 – Registration Fee

The proposed rule provides that each applicant must pay a registration fee and that the Board will announce the registration fee from time to time. While the Board has not yet established the registration fee amount, the Board has indicated that an applicant's fee amount will be determined by a formula and that registration fees with vary with the size of the applicant. The Section agrees with the concept of such a formula, because the Section assesses its dues based on the number of CPAs in a firm as well as the number of the SEC clients a firm serves as primary auditor. If the Board uses a formula similar to SEC client or issuer data, the Board should be careful about not double-counting the number of issuers as more than one firm may be involved in an audit of an issuer. We believe that it is critical that the process for determining registration fees be as equitable as possible. To facilitate this result, we believe that the Board should publish its suggested approach and afford a reasonable time for public comment on that approach.

Rule 2105 – Action on Applications for Registration

The proposed rule provides that the Board will take action on a registration within 45 days of its receipt. At that time, the Board will approve the application, request more information from the applicant, or disapprove of the application by written notice to the applicant. The Board's proposal does not, however, contemplate due process procedures through which a rejected applicant can seek review of the Board's determination or otherwise seek the Board's reconsideration. We believe that the Board should establish formal, fair procedures for applicants to seek and obtain review of a disapproval decision.

Rule 2300 – Public Availability of Applications and Reports

The proposed rule provides for the nondisclosure of certain confidential information. We agree with the Board's intent to treat certain information confidential and believe the availability of such treatment is essential to the registration process. However, the proposal does not appear to provide the applicant with due process procedures in the event that the Board determines that certain information will not be treated confidentially. We believe that the Board should establish formal, fair procedures for applicants to seek and obtain review of a disapproval decision.

In addition, for the information that the Board has granted confidential treatment, the Board has stated it will provide that information to the Commission or to comply with a subpoena validly issued by a court or other body of competent jurisdiction. The Section clearly understands and supports the close relationship between the Board and the Commission; however, we are concerned that without more protection there will be an increased likelihood that the information will lose its confidential character. Further, once the information is provided to the Commission, the information might be deemed subject to disclosure under the Freedom of Information Act ("FOIA"). The Section recommends that to help ensure confidentiality for the party with the ultimate interest in maintaining such confidentiality, the Board expressly state in its final rule its intention to provide the Commission with any necessary information about the person on whose behalf it is seeking confidential treatment and that it will, in any event, notify the relevant applicant of any FOIA request for access to an applicant's information.

In addition to information provided to the Commission, the Section is concerned with the Board's intent to provide confidential information in response to a subpoena. The Section is concerned that the Board will become a third-party witness in multitudes of civil litigation, and that firms' confidential information will quickly become public. Accordingly, the Section recommends that the Board only respond to subpoena requests in criminal matters.

**SPECIFIC COMMENTS PERTAINING TO THE APPLICATION FORM**

Part 1 – Identify of the Applicant

- *Item 1.1 – Name and Identification Number of Applicant* – This requirement could be construed to require each applicant to scrutinize all of its acquisitions within the past five years and identify each of the names under which its "predecessors" conducted audits. We recommend that the Board define the term "predecessor" because it is unclear whether the term includes every entity from which an applicant has acquired assets (including personnel), or those from which the applicant has assumed liabilities. We recommend that the Board define the term to apply only to acquired firms (or firm name changes), and to exclude entities as to which the applicant has acquired no liability.

- *Item 1.8 – Required Licenses and Certification* – The Board's proposed rules require the "applicant and all individual accountants associated with the applicant who participate in or contribute to the preparation of audit reports have all licenses and certifications required by governmental and professional organizations." This proposed rule requires clarification in the following areas:
    - It is unclear whether the question will require a "yes/no" answer or whether the Board is requiring the applicant to supply a detailed listing of license and certification information. If requiring a "yes/no" answer, one infraction out of 10,000 employees could trigger a "no" answer for the entire firm. Again, we suggest that the definition of "accountant" for registration purposes be only applicable to those that have the authority to sign a firm's name.
    - It is unclear whether the question seeks information on all licenses, even if they are not required. For instance, some individual accountants may have CPA licenses in several states, although it is not required. It is not clear if a registering firm should provide information only on the required license or for all licenses held.
    - It does not recognize that some accountants will not have licenses yet. In many U.S. states, an accountant may not apply for a license until he or she has a certain level of accounting experience (such as a 2-year experience requirement). These individuals would be appropriately labeled as "accountants" although they would not maintain a CPA certification.

  In order to avoid confusion, we suggest that the Board eliminate this entire section and focus on certifications and licenses of the applicant (as requested in Item 1.7).

Part II – Listing of Applicant's Public Company Audit Clients and Related Fees

In the Section-by-Section Analysis to the proposing release, the Board states that it has, "to the extent possible," used concepts from the fee disclosures required of issuers under the revised proxy disclosure rules recently adopted by the Commission. The fee disclosures proposed by the Board, however, differ significantly from those required under the Commission's new rules. The Section has long-recognized the difficulty of its member firms to provide extensive fee information. We believe the Board should reconsider the need for

applicants to provide extensive fee information as currently outlined in Part II of proposed Form 1. Issuers are already required to disclose substantially similar information about fees paid to their outside auditors under the Commission's proxy rules, and this information is publicly available through the Commission's EDGAR system.

To the extent the Board determines that it is appropriate to require the enhanced level of disclosure reflected in its proposal, we believe the Board's proposed rules should be harmonized with the fee disclosures required under the Commission's revised proxy disclosure. Further, the Board should recognize that categorizing fees for both the current and prior year would pose challenges to the firms as they would be required to recast fee information using different sets of rules. It is also unclear what is meant by current and prior years. We assume this is based on the date of the audit report itself and not on the date of the financial statements covered by that report. Thus, if a firm registers during calendar year 2003, the "preceding calendar year" would be 2002 and thus an audit report issued in early 2002 for December 31, 2001 year-end financial statements would be listed.

The fee related questions also call for registering firms to provide information as to issuers for which audit reports are prepared or issued during the specified calendar year. If a firm registering has merged with another firm, acquired another firm, or divested a segment of its firm, during or subsequent to the period covered, it is unclear how the acquiring firm should report audit report fee information by its predecessor, acquired or divested firms.

The fee information sections call for registering firms to provide the SIC code of the issuer as the issuer has "most recently disclosed" in its filings with the Commission. We suggest allowing the registering firms to provide the SIC code from the filing that contains the audit report being covered. Some registrants change their businesses over time, are acquired by other entities, divest of operations, and so on, any of which may change the SIC code for the issuer.

For the reasons enumerated above, the Board should also allow applicants sufficient time to prepare the fee information. We believe that this will most certainly necessitate time beyond the anticipated application submission deadline of early September 2003. As previously mentioned, the Section has long-recognized the difficulties encountered by firms in obtaining fee information as it often requires enormous resources. Accordingly, we suggest the Board consider some type of transitional provision to enable this information be provided at a later date.

Additionally, proposed Item 2.4 sets forth a requirement that applicants provide information regarding issuers for which an applicant played or expects to play a substantial role in the preparation or furnishing of an audit report during the preceding or current calendar year. This goes beyond the requirements of the Act and we believe that the Board should carefully consider whether the costs of requiring applicants to compile and provide this information are justified by the resulting benefits. Of particular concern is the requirement for the applicant to provide a "brief description of the applicant's role with respect to the audit report." We believe there are legal exposures for firms in answering this question, which are not

necessary. We believe it is sufficient for firms to solely indicate those issuers for which they played a substantial role in the audit.

In addition, throughout Part II, the Board requests the date of the audit report as relevant information. We suggest that the Board request the date of the issuer's fiscal year-end, as it is a more relevant date. It also eliminates confusion in including the audit report date when an audit report has been dual-dated.

Part III – Applicant Financial Information

The proposal requires disclosure of financial information that goes beyond what is mandated by the Act, and the Section does not consider it appropriate or relevant to extend the requirements in this area. Further, the Section does not consider it necessary to impose on firms the substantial additional burden of compiling and reporting information with respect to non-issuers.

If, however, the Board determines that it is appropriate to obtain information about non-issuers, and further determines that the Board has the authority to do so, we believe that the information should be limited to fees for audit services, and applicants should be permitted to provide percentage calculations showing the relative proportions of audit fees received from issuers and non-issuers.

Other areas requiring clarification are as follows:

- The section calls for the registering firm to provide fee information as to "fees received." Information as to "fees received" appears to be cash collection, and will not match with proxy disclosures which are fees billed.
- The section is not clear as to how firms should provide historical information with respect to mergers, acquisitions of another firm or divestures of a segment of a firm.

Part IV – Statement of Applicant's Quality Control Policies

The Board's proposal in this area would require a registering firm to furnish a "narrative, summary description, in a clear, concise and understandable format, of the quality control policies of the applicant for its accounting and auditing practices, including procedures used to monitor compliance with independence requirements." Without clarification surrounding the parameters of the information the Board is seeking, we anticipate applicants providing a range of information from little to none to voluminous statements.

We suggest that this section should be revised to require disclosure as to whether the applicant follows the quality control standards of the AICPA or another professional body. For non-U.S. applicants who are foreign associated firms of the U.S. SECPS member firms, this could also include disclosure of the adoption of the quality control procedures under Appendix K of the Section's membership requirements.

We also suggest that the Board ask the applicant to make reference to its most recent peer review report. (Peer review reports of all SECPS member firms are publicly available on the AICPA's website at http://www.aicpa.org).

Part V – Listing of Certain Proceedings Involving the Applicant's Audit Practice

The Board's proposal in this area seeks to expand upon the Act by requiring applicants to provide information about proceedings that are no longer pending and about proceedings not related to the firm's audits of public companies. We believe that the final rule should be more aligned with the Act, as the additional information is not necessary and it is burdensome to obtain. We also have comments in the following areas:

- The proposal sets forth different time periods ranging from the last twelve months to ten years for which applicants are required to report prior adverse proceedings. We recommend that these periods be harmonized with each other, and limited to the last three years. The Board likely determined that different time periods were appropriate because of its perception that some types of proceedings were more serious than others. We understand that viewpoint, but believe that divergent disclosure rules will be confusing and will hamper applicants' ability to collect accurate information from their partners and employees.
- Applicants should not be required to provide information about proceedings unrelated to audit reports. The breadth of the proposed reporting requirement would impose a substantial burden on the applicant to collect the necessary information and the resulting benefit would be minimal.
- The proposal requires information about administrative and disciplinary actions in connection with audit reports. The proposal makes reference to any professional association or body. The AICPA has two Committees that perform investigations – the SECPS Quality Control Inquiry Committee and the AICPA Professional Ethic Executive Committee. The majority of findings by these bodies are confidential, or certainly do not disclose the level of information that is proposed by the Board. In the interest of protecting both individuals and firms, we recommend that disclosure only be required to the extent that such findings have already been made public.

Finally, the Board's proposal permits an applicant to describe the proceeding and the reasons that, in the applicant's view, such proceeding should not be a basis for the denial of its application for registration. The Board should specify the reasons why a firm would not be registered based on litigation. Given the current litigious environment in the U.S., accounting firms are often named as defendants in class action and other lawsuits. The premise of "innocent before proven guilty" should be recognized by the Board, and a firm should not be tainted because it has been served with litigation.

Part VI – Listing of Filings Disclosing Accounting Disagreements with Public Company Audit Clients

The Board's proposal would require an applicant to identify instances in which its audit clients have disclosed disagreements with the applicant and furnish specified information about those instances. The Commission requires issuers to disclose such disagreements under Item 304(a) of Regulation S-K. Because issuers already report this information pursuant to Commission rules, we believe the Board should reconsider whether it is necessary to require applicants to provide the level of detail as currently proposed.

In addition, the Board should recognize that some registering firms may have reported disagreements with issuers where they nevertheless remain the auditor. The proposal appears to require reporting only those disagreements where the registering firm is no longer the auditor, and to exclude other disagreements.

Part VII – Roster of Associated Accountants

The Board's proposal would require U.S. firms to provide much more data than is required by the Act by demanding information regarding "all accountants associated" with the firm. Requiring U.S. firms to provide a list of all accountants associated with the firm – even those who do not participate in or contribute to the preparation of audit reports – does not seem to have any direct relationship to the Board's tasks, and would be exceptionally burdensome for firms. Instead of requiring the disclosure of all accountants, we believe that the best manner in which to streamline the proposed reporting obligations into a simpler form is to refine the definitions for "accountant" and "audit reports." Therefore, only audit partners, who have the ability to bind the firm and sign audit reports, should be listed on this form. Finally, as previously stated, we recommend that the Board should not require firms to provide their accountants' social security numbers.

Part VIII – Consents of Applicant

The proposal requires applicants to secure consents within 45 days of submitting the application for registration. This time period may not allow enough time to reasonably obtain these consents. A number of such individuals may currently be away on military service, may work only during certain months, may be on maternity leave or may be on extended vacation. We suggest increasing the time limit and also allowing consents to be obtained when a person returns to active employment.

If further information is also required by the Board before an application is accepted, it may happen that consents will become more than 45 days old and have to be renewed again. We suggest that the Board extend the 45-day period to a 90-day period so that firms do not have to go on a paper chase trying to ensure consents are current.

## CONCLUSION

We acknowledge the enormous effort put forth by the members and staff of the PCAOB to implement the provisions of the Act. The effective registration of public accounting firms is 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 system of registration. We are firmly committed to working with the PCAOB in accomplishing the timely and effective implementation of the Act, including that of the registration system, and would welcome the opportunity to meet with you to clarify any of our recommendations.

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Sincerely,

Robert J. Kueppers
Chair
SECPS Executive Committee