



National Association of State Boards of Accountancy

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May 8, 2003

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

Re: PCAOB Rulemaking Docket Matter No. 004
PCAOB Release No. 2003-005, April 18, 2003
(Statement Regarding the Establishment of Auditing and Other Professional Standards)

Dear Board Members:

We appreciate the opportunity to offer comment to the Public Company Accounting Oversight Board (the “Board” or the “PCAOB”) on its proposal regarding the Establishment of Auditing and Other Professional Standards and related proposed Rules that are being considered by the Board for adoption and submission to the Securities and Exchange Commission (the “Commission” or the “SEC”).

As the national organization of all U.S. state accountancy regulators, the National Association of State Boards of Accountancy (NASBA) respects the Board’s efforts to implement promptly the requirements of the Sarbanes-Oxley Act of 2002 (the “Act”) that are entrusted to the Board. NASBA’s member boards (the “State Boards”) are composed of both licensees and non-licensee public members. As enforcers who are the only authorities empowered to grant or revoke licenses of CPAs (certified public accountants), NASBA’s member boards understand the delicate balance between the need for swift discipline and the necessity of procedural fairness.

As before, NASBA’s comments here give special attention to facilitating federal/state cooperation.

I. General Comments.

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.

NASBA supports the proposal for the PCAOB's establishing professional auditing standards (to be defined to include auditing standards, standards for attestation engagements, quality control policies or procedures, ethical or competency standards, and independence standards) with input and assistance from one or more advisory groups.

We are pleased to see in footnote 8 of the proposing release that the PCAOB anticipates state accounting regulators will be represented on the advisory group(s). The involvement of state accounting regulators is especially appropriate with respect to ethical, competency and independence standards since state regulators regularly address such matters. Additionally, the public protection efforts at both levels will be enhanced by improved communication among enforcers, harmonization of approaches to shared objectives, and appreciation of procedural, as well as prioritization, differences.

However, as noted below, we do urge that "State regulatory authorities or an association of State regulatory authorities" be included *expressly* among those persons who provide recommendations to the PCAOB of possible advisory group members.

The release notes that the PCAOB plans to publish proposed new or amended professional auditing standards for a comment period normally of at least 21 days. We encourage the PCAOB to consider whether a longer comment period may be appropriate for particular proposals. In making such a determination, the PCAOB could consider the nature, scope and complexity of the proposal, the significance of the proposal, the likely breadth and degree of interest by various groups, and the appropriateness of encouraging comment on the particular proposal by State Boards, which meet only monthly in many states.

II. Comments on Selected Provisions of the Proposed Rules.

Proposed Rule 1001. Definitions of Terms Employed in Rules.

We suggest the addition of definitions of "State" and "State regulatory authority" for use in changes we offer below for proposed Rules 3100 and 3700.

Add a definition of "State" based on the definition in the Act: "The term 'State' means any State of the United States, the District of Columbia, Guam, Puerto Rico, the Virgin Islands, or any other territory or possession of the United States." (Assuming that this definition is included, references in various Rules to "state" would be changed to "State" as appropriate.)

Add a definition of "State regulatory authority" adapted from the definition of "appropriate State regulatory authority" in the Act: "The term 'State regulatory authority' means the State agency or other State authority responsible for the licensure or other regulation of the practice of accounting in the applicable State."

Proposed Rule 3100. Professional Auditing Standards Applicable to Registered Public Accounting Firms. We agree that it is useful to provide expressly that a registered public accounting firm and its associated persons shall comply with all applicable professional auditing standards.

In the proposing release the PCAOB seeks views on whether there are other standards, in addition to its professional auditing standards, with which the PCAOB should require registered public accounting firms to comply. NASBA believes it is fundamental that registered public accounting firms and their associated persons comply with applicable licensing requirements. The failure to adopt such a requirement could undermine the constitutionally preserved ability of each State to protect its citizens from unauthorized practice and from violations of complementary State regulations. Thus, as noted also in Part III below, NASBA urges the PCAOB to require that a registered public accounting firm and each of its associated persons be duly licensed, registered or permitted or otherwise hold valid practice privileges and be in good standing under the laws of each applicable State [defined as noted above] and each other applicable jurisdiction where or with respect to which the activities of the accounting firm or the associated person require the accounting firm or the associated person to be licensed, registered or permitted or otherwise hold valid practice privileges under the laws of the State or other jurisdiction or the rules, regulations or policies of the appropriate State regulatory authority or other jurisdictional regulatory authority.

We believe that, *at a minimum*, the PCAOB should require a registered public accounting firm and each of its associated persons to comply with any applicable *requirements of the Commission for recognition* of the accounting firm or the associated person *by the Commission*, including those set forth in Regulation S-X of the Commission, as it may be amended from time to time.

Proposed Rule 3700(c). Advisory Groups – Selection of Members of Advisory Groups.

NASBA agrees with the proposal that the PCAOB convene one or more advisory groups to assist it in carrying out its responsibility to establish professional auditing standards. NASBA also agrees with the proposal that the PCAOB, at its discretion, select members of advisory groups based upon recommendations provided by a variety of persons or bodies having an interest in the accuracy of public company financial statements. We do believe quite strongly, however, that the list of sources of recommendations should include *express* reference to state accounting regulators. We request that you add to the list: “State regulatory authorities or an association of State regulatory authorities.” We suggest that the term “State regulatory authority” be defined as noted above in our comments on proposed Rule 1001. NASBA and the State Boards have a strong interest in the proper conduct of the public accounting profession, including the proper audit of public company financial statements. We believe that *express* reference to State regulatory authorities or an association of State regulatory authorities would be at least as appropriate as various other categories of recommending persons included in the proposed list. Further, we suggest that “State and federal regulation” might be included in the list of areas of expertise for advisory group members. We strongly believe that state accounting regulators should be represented on the advisory group(s) and are pleased that the PCAOB anticipates this will be the case.

Proposed Rule 3700(e). Advisory Groups – Ethical Duties of Advisory Group Members.

Proposed Rule 3700(e) provides, “Members of an advisory group shall comply with EC 3, EC 8(a) and EC 9 of the Board’s Ethics Code.” The analysis in Appendix 2 of the proposing release

notes that these provisions of the proposed Ethics Code address, respectively, “general ethical principles applicable to service for the Board, disqualification in the case of conflicts of interest, and the non-disclosure of non-public information.”

We suggest that advisory group members also comply with EC 14 [certification] of the proposed Ethics Code, adapted to provide that members of an advisory group agree to comply with [specified provisions of] the Ethics Code at the commencement of their service with the advisory group and shall annually certify in writing their continuing compliance therewith.

We also wonder if consideration might well be given to adapting EC 13 [waiver] for advisory group members. The proposing release notes that the PCAOB contemplates the advisory group “will be comprised of individuals with a variety of perspectives, including practicing auditors, preparers of financial statements, the investor community and others.” Thus there may be a greater likelihood that an advisory group member (distinguished from a PCAOB Board or staff member) may have “a financial interest or other similar relationship which might affect or reasonably create the appearance of affecting his or her independence or objectivity.” The more conscientious the advisory group member (and the more rigorously she or he applies the general principles of EC 3 and the disqualification standard of EC 8(a)), the more likely a possible decision to recuse herself or himself absent a formalized waiver approval process. Such a withdrawal may be appropriate since (compared with the PCAOB and its staff) some element of lessened individual independence and objectivity (or at least the appearance of lessened individual independence and objectivity) may be inherent in the composition of an advisory group intentionally drawn from varied constituencies.

III. Prospective Future Rulemaking by the PCAOB or the Commission.

NASBA urges that care be taken by the PCAOB and the Commission in drafting various regulations so as not to dilute the existing requirement for Commission recognition that a certified public accountant be "duly registered and in good standing as such under the laws of the place of his residence or principal office" and that a public accountant be "in good standing and entitled to practice as such under the laws of the place of his residence or principal office." [Rule 2-01(a) of Regulation S-X; 17 CFR 210.2-01(a)] Accordingly, the current license status of all accountants associated with registered public accounting firms and firms applying for registration (in addition to the firms themselves) should be regularly checked with State Boards directly, or facilitated through NASBA.

NASBA urges that the PCAOB encourage the Commission to add to the requirements of Regulation S-X regarding "Qualifications of Accountants" a requirement for Commission recognition [and/or, as noted above in our comments on proposed Rule 3100, that the PCAOB itself require] that an accounting firm and each of its associated persons be duly licensed, registered or permitted or otherwise hold valid practice privileges and be in good standing under the laws of each applicable State [defined as noted above] and each other applicable jurisdiction where or with respect to which the activities of the accounting firm or the associated person require the accounting firm or the associated person to be licensed, registered or permitted or otherwise hold valid practice privileges under the laws of the State or other jurisdiction or the

rules, regulations or policies of the appropriate State regulatory authority or other jurisdictional regulatory authority.

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,

A handwritten signature in black ink, appearing to read "K. Michael Conaway". The signature is stylized and cursive.

K. Michael Conaway, CPA
Chair, NASBA

A handwritten signature in black ink, appearing to read "David A. Costello". The signature is stylized and cursive.

David A. Costello, CPA
President & CEO, NASBA