

September 11, 2007

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

**RE: PCAOB Rulemaking Docket Matter No. 017 – Proposed Ethics and Independence Rule 3526, *Communication with Audit Committees Concerning Independence* and Proposed Amendment to Rule 3523, *Tax Services for Persons in Financial Reporting Oversight Roles*, PCAOB Release No. 2007-008**

Dear Mr. Secretary:

The Center for Audit Quality (CAQ) is an autonomous public policy organization serving investors, public company auditors and the capital markets. The CAQ's mission is to foster confidence in the audit process and to aid investors and the markets by advancing constructive suggestions for change rooted in the profession's core values of integrity, objectivity, honesty and trust. Based in Washington, D.C., the CAQ is affiliated with the American Institute of Certified Public Accountants (AICPA). The CAQ consists of approximately 800 member firms that audit or are interested in auditing public companies.

We welcome the opportunity to share our views on Public Company Accounting Oversight Board (PCAOB or the Board) Release No. 2007-008. Due to the subject matter of the Release, the Center has received significant input from the AICPA Professional Ethics Executive Committee (PEEC) and accordingly, this letter is being issued jointly with PEEC.

**General Comments and Recommendations with Respect to the Proposed Amendment to Rule 3523**

The CAQ and PEEC support the PCAOB's proposed amendment to Rule 3523 to eliminate the prohibition against providing tax services to persons in a financial reporting oversight role during the portion of the "audit period" that precedes the "professional engagement period." We also support the PCAOB's proposed amendment to Rule 3523 to add the footnote explaining the application of Rule 3523 in the context of an initial public offering. These proposed changes are consistent with recommendations we made in our response to PCAOB Release No. 2007-002 and, in our view, do not diminish the effectiveness of the rule in maintaining auditor independence and investor confidence.

Public Company Accounting Oversight Board  
Office of the Secretary  
September 11, 2007  
Page 2 of 6

However the Board has not proposed two additional amendments to Rule 3523 that were included in our response to PCAOB Release No. 2007-002. Accordingly, we repeat the substance of those recommendations in the context of the proposed amendments:

1. The note the Board proposes to add to Rule 3523 explains the application of the rule in the context of an initial public offering, which is only one of several ways in which an audit client and its auditor can first become subject to the rule. For example, an audit client and its auditor can become subject to the PCAOB auditing and related professional practice standards through a reverse merger with an existing issuer, through acquisition by an existing issuer, or by exceeding the 500-shareholder threshold requiring the filing of a registration statement. We assume the Board intends that note to be applied in other circumstances where the audit client and the auditor first become subject to the rule; therefore, we recommend that the PCAOB expand the note to Rule 3523 to state, “In the context of an initial public offering, *reverse merger, or similar event that causes a registered public accounting firm to first become subject to the PCAOB’s auditing and related professional practice standards with respect to an issuer,* the provision of .....
2. We recommend that the 180-day transition period provided for the completion of tax services in process to persons hired or promoted into a financial reporting oversight role in Rule 3523 (c) be extended to persons in such a role at a new audit client or in situations such as those described above.

We believe, in the first instance, that failure to recognize situations similar to an initial public offering would result in significant hardship (including potential reaudits of all periods presented in the filing) to entities that first become subject to Securities and Exchange Commission (SEC) reporting requirements as a result of events (such as those described above) other than an initial public offering (an “other corporate life event”). We believe that a significant number of companies and their auditors first become subject to the SEC reporting requirements (and the PCAOB’s auditing and related professional practice standards) from other corporate life events. In substance, we believe that Rule 3523 should not be applied retroactively and should only apply from the point in time that the registered public accounting firm agrees to, or begins to, perform an audit in accordance with the standards of the PCAOB.

In the second instance, we believe the lack of a transition period for tax services in process for persons in a financial reporting oversight role at a new audit client or at an audit client that first becomes subject to the PCAOB’s auditing and related professional practice standards would place such persons in a position of hardship and severe disadvantage as compared to their counterparts who received a transition period upon adoption of the rule and as compared to persons hired or promoted into such positions for which the rule specifically grants a 180-day transition period. We believe 180 days is a reasonable period to complete services in process and effect a transition to a new service provider. Failure to grant a transition period in these circumstances would force any

Public Company Accounting Oversight Board  
Office of the Secretary  
September 11, 2007  
Page 3 of 6

such persons currently using the audit firm for their personal tax services to switch service providers for tax services in process at the date of engagement of the auditor, almost certainly at significant cost and personal inconvenience.

We do not believe these additional changes would diminish the effectiveness of Rule 3523 in maintaining auditor independence and investor confidence.

### **General Comments and Recommendations with Respect to Proposed Rule 3526**

In our comment letter on PCAOB Release No. 2007-002, we noted the requirements of Independence Standards Board Standard No. 1 and stated that, in our view, the requirements of that standard provided an excellent safeguard for preserving auditor independence. We are supportive of proposed Rule 3526 and offer the following general comments with respect to the proposed rule:

1. Although not explicitly stated in the proposed rule, PCAOB Release No. 2007-008 states, “The proposed rule would require disclosure of all relationships that may reasonably be thought to bear on independence whether those relationships existed during the period under audit or during earlier periods.” This statement implies that the communication and discussion between the registered public accounting firm and the audit committee of the issuer should potentially include communication and discussion of relationships that existed in periods prior to the beginning of the audit and professional engagement period or that had been communicated, discussed and resolved in prior years. We believe that the Board should not specify the period that should be covered and allow auditors and audit committees to agree on the relevant criteria for reporting such relationships. We address this matter in further detail in our response to Question #5 below.
2. The proposed rule would remove the phrase “in the auditor’s professional judgment” from the requirement to describe, in writing, relationships that may reasonably be thought to bear on independence. PCAOB Release No. 2007-008 acknowledges, however, “Auditors will, of course, need to apply professional judgment to determine what is reasonable under particular facts and circumstances.” We do not object to the deletion of this phrase provided the final release contains a similar acknowledgment that the auditor must apply professional judgment in determining which matters are required to be communicated to the audit committee.
3. While we agree with the Board that requiring the communication and discussion with the audit committee prior to the engagement of the auditor only makes sense and we support it in the case of a new audit client, we are concerned that, in certain other circumstances, imposing that requirement may unnecessarily delay the filing of an initial public offering or the closing of a transaction. Under Independence Standards Board Standard No. 1, an auditor may begin work (for example on an existing audit client that decides to file a

Public Company Accounting Oversight Board  
Office of the Secretary  
September 11, 2007  
Page 4 of 6

registration statement for an initial public offering) based upon an initial review of relationships between the firm and the audit client. The firm would then simultaneously initiate the more comprehensive review of such relationships that would be necessary to support the required communications (which would have to occur prior to the filing of any report with the SEC). If the proposed rule is adopted, registered firms could not begin work until the comprehensive review was completed, which could delay the filing of the registration statement by anywhere from a few days to a few weeks. As the Board knows, time is often of the essence when a company decides to file an initial public offering or initiate a transaction.

### **Comments and Recommendations with Respect to Matters for which Comments were Specifically Solicited**

#### **1. Would proposed Rule 3526 assist registered firms and audit committees in fulfilling their respective obligations with respect to auditor independence?**

We are supportive of proposed Rule 3526 and believe that Independence Standards Board Standard No. 1 already requires accounting firms to make the kinds of communications that would be required by proposed Rule 3526. Accordingly, the purpose of the proposed rule appears to be to (a) expand the communications to include relationships between the auditor and persons in a financial reporting oversight role at the audit client; (b) require the communications prior to engagement of the auditor; (c) remove the phrase “in the auditor’s professional judgment” as a modifier to the phrase “relationships that may reasonably be thought to bear on independence”; and (d) require the audit firm to document the substance of its independence discussions with the audit committee.

We have addressed specific implementation and transition issues in our general comments on the proposed rule and responses to certain questions included in the Release.

#### **2. Would proposed Rule 3526 assist audit committees in making a decision regarding the appointment of a new auditor?**

We believe that audit committees should possess knowledge of the relationships contemplated by Rule 3526 prior to appointing their auditor. We believe that auditors are currently identifying all such relationships as part of the proposal process for a new audit client and auditors and audit committees are currently discussing and resolving such matters prior to the appointment of the auditor. Accordingly, we do not believe the rule would significantly change practice.

Public Company Accounting Oversight Board  
Office of the Secretary  
September 11, 2007  
Page 5 of 6

**3. Should proposed Rule 3526 require the registered public accounting firm to communicate any additional matters on auditor independence to the audit committee? If so, what specific communications should the auditor be required to make to the audit committee?**

No, we believe audit committees and auditors are currently working together to identify any additional information regarding auditor independence that should be communicated and discussed based on the unique facts and circumstances of the company.

**4. To what extent if any, are accounting firms already making the kinds of communications that would be required by proposed Rule 3526?**

See response to questions 1 and 2 above.

**5. Should the initial communication required under proposed Rule 3526(a) be limited to relationships that existed during a particular period? If so, why and how long should the period be?**

The relationships that are deemed to potentially impair an audit firm's independence are generally limited to those that existed during the audit and professional engagement period. Accordingly, the initial communication should cover all relationships that existed during the audit and professional engagement period, which in the case of an initial public offering or reverse merger, could cover several years. Relationships that existed prior to the beginning of the audit and professional engagement period may be relevant to the extent those relationships have continuing implications during the audit and professional engagement period or limit the auditor's ability to audit adjustments to financial statements of prior periods. As a general rule, relationships that existed prior to the beginning of the earliest audited period included in the audit client's current SEC filings would not be relevant.

We believe that the rule need not specify the period to be covered during the initial communication and that subsequent annual communications should be limited generally to relationships that existed subsequent to the most recent annual (or, initial in the case of the first annual) communication. We believe that guidance of this nature is best set forth in the discussion contained within the rule release rather than within the rule itself.

**6. Should the Board provide a transition period in Rule 3523 to allow a registered public accounting firm to complete covered tax services once the professional engagement period begins? If so, why is such a transition period necessary? How long should any such transition period be?**

Public Company Accounting Oversight Board  
Office of the Secretary  
September 11, 2007  
Page 6 of 6

When the Board adopted Rule 3523 it provided for an approximately 180-day transition period for engagements in process at the date of adoption. In addition, the Rule provides for a 180-day transition period for engagements in process at the date of a hiring or promotion event. Presumably, these transition periods were provided in order to allow persons in a financial reporting oversight role that had a pre-existing professional service relationship with the audit firm a reasonable period of time to complete work in process and engage another service provider for future services. In order to avoid imposing a hardship (transitioning services in process to another firm at significant cost and personal inconvenience), we believe these same transition periods should be afforded to persons in a financial reporting oversight role at a new audit client or an existing audit client that first becomes subject to the PCAOB's auditing and related professional practice standards. We also point out that persons subject to the rule live in various jurisdictions with varying tax filing dates and that, in the case of entities that first become subject to the rule, all such persons may not even have been identified at the time of the occurrence of the event that gives rise to the application of the rule.

We appreciate the opportunity to comment on PCAOB Release No. 2007-008 and would welcome the opportunity to respond to any questions you may have regarding any of our comments and recommendations.

Sincerely,



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Executive Director  
Center for Audit Quality



Bruce P. Webb  
Chair, AICPA Professional Ethics Executive Committee

cc: Mark W. Olson, Chairman  
Kayla J. Gillan, Member  
Daniel L. Goelzer, Member  
Willis D. Gradison, Member  
Charles D. Niemeier, Member  
Thomas Ray, Chief Auditor and Director of Professional Standards