

April 30, 2012

EXECUTIVE DIRECTOR

Cynthia M. Fornelli

GOVERNING BOARD

Chairman

Robert E. Moritz, Chairman and Senior Partner
PricewaterhouseCoopers LLP

Vice Chair

Charles M. Allen, CEO
Crowe Horwath LLP

Vice Chair

Harvey J. Goldschmid, Dwight Professor of Law
Columbia University

Joe Adams, Managing Partner and CEO
McGladrey & Pullen, LLP

Stephen Chipman, CEO and Executive Partner
Grant Thornton LLP

Joe Echevarria, CEO
Deloitte LLP

Michele J. Hooper, President and CEO
The Directors' Council

Stephen R. Howe, Jr., Managing Partner
Ernst & Young LLP

Barry C. Melancon, President and CEO
AICPA

Lynn S. Paine, Professor of Business
Administration and Senior Associate Dean,
Director of Faculty Development
Harvard Business School

John B. Veihmeyer, U.S. Chairman and CEO
KPMG LLP

Jack Weisbaum, CEO
BDO USA, LLP

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

Re: Request for Public Comment: *Proposed Amendments to Conform the Board's Rules and Forms to the Dodd-Frank Act and Make Certain Updates and Clarifications*, PCAOB Rulemaking Docket Matter No. 039

Dear Office of the Secretary:

The Center for Audit Quality (CAQ) is an autonomous public policy organization dedicated to enhancing investor confidence and public trust in the global capital markets. The CAQ fosters high quality performance by public company auditors, convenes and collaborates with other stakeholders to advance the discussion of critical issues requiring action and intervention, and advocates policies and standards that promote public company auditors' objectivity, effectiveness, and responsiveness to dynamic market conditions. Based in Washington, D.C., the CAQ is affiliated with the American Institute of Certified Public Accountants (AICPA).

The CAQ appreciates the opportunity to respond to the Public Company Accounting Oversight Board (PCAOB or the Board) on its *Proposed Amendments to Conform the Board's Rules and Forms to the Dodd-Frank Act and Make Certain Updates and Clarifications* (Proposed Amendments) as published in PCAOB Release No. 2012-002 dated February 28, 2012 (Release). This letter represents the observations of the CAQ, but not necessarily the views of any specific firm, individual, or CAQ Governing Board member.

Overall Comments

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) amended various provisions of the Sarbanes-Oxley Act of 2002 by giving the Board oversight authority with respect to audits of brokers and dealers. The Dodd-Frank Act provides the Board with the authority to promulgate standards, conduct inspections, and undertake investigations and disciplinary proceedings with respect to the audits of brokers and dealers. We support the changes to the Board's rules and forms to reflect this oversight authority. We recommend that the Board consider the following observations that we believe will enhance the effectiveness of the Proposed Amendments.

General Provisions (Section 1)

The Board has requested comment on its Proposed Amendments to the defined terms in Rule 1001 in Section 1 of the Board's rules. We note that the proposed changes to Rule 1001(p)(i), "Person Associated with a Public Accounting Firm (and Related Terms)," include requirements related to persons "seeking to become associated" with a public accounting firm. We suggest that the Board clarify the meaning of this term and provide guidance regarding when a person would qualify as "seeking to become associated." For example, what conduct would establish that a person either is or is no longer "seeking to become associated?"

Professional Standards (Section 3)

The Proposed Amendments to Section 3 of the Board's rules would make certain auditing and related professional practice standards applicable to the audits of brokers and dealers. We offer the following comments in this area:

1. ***Proposed Change to Rule 3400T, Interim Quality Control Standards (b)*** – The proposed rule change to Rule 3400T(b) deletes "(1)" in regard to Section 1000.08(n) of the AICPA SEC Practice Section (SECPS) Manual. The interim standard adopted by the PCAOB is limited to section (n)(1) and does not include section (n)(2). Since the existing rule refers to the SECPS Requirements of Membership as in existence on April 16, 2003 in the SECPS Manual, removing the "(1)" appears to remove that limitation, causing the PCAOB's proposed rule to now include all of SECPS 1000.08(n). This adds section (2) which was not originally adopted by the PCAOB and reads, "report annually, pursuant to SECPS 1000.08g (3), the name and the country of the foreign associated firms, if any, for which the SECPS member firm has been advised by written representation from its international organization or the individual foreign associated firms that such policies and procedures have been established." We understand that the intent of the PCAOB was to keep the rule as originally adopted and we therefore recommend that the proposed change to Rule 3400T(b) be corrected to retain the "(1)" in Section 1000.08(n).
2. ***Rule 3523, Tax Services for Persons in Financial Reporting Oversight Roles*** – The Board has requested comment on whether Rule 3523, which generally prohibits auditors from providing tax services to any person who performs a financial reporting oversight role at an audit client, should apply to the audits of all brokers and dealers. We believe that Rule 3523 should only apply to the audits of issuer brokers and dealers, and broker and dealer subsidiaries of issuers. The financial statements of non-issuer brokers and dealers are not used by investors to the same extent as the financial statements of issuers, and the provision of tax services to an officer of a non-issuer broker and dealer does not create the same appearance of a mutuality of interest between the auditor and those individuals as it does for a public company whose officers may have interests that differ from those of its investors.

Additionally, the application of Rule 3523 to non-issuer brokers and dealers would result in increased costs to small business by requiring a second individual or firm to perform certain services (e.g., tax work), particularly for smaller brokers and dealers structured as partnerships. In these instances, smaller brokers and dealers would have to terminate existing business relationships with entities that have knowledge of their business activities and books and records and identify another unrelated individual or firm to perform these services.

If the Board chooses to require the application of Rule 3523 for the audits of non-issuer brokers and dealers, we believe that it should provide clarification on the application of this rule to brokers and dealers that are subsidiaries of non-issuers. For example, there could be instances where an auditor may perform the audit of a broker and dealer that is a small component of a larger non-public entity (Company A) and the auditor currently provides tax services to Company A, including the tax compliance work for



Company A's executive officers, in accordance with AICPA independence standards. One interpretation of the Proposed Amendments could be that the auditor would be required to stop providing tax compliance services to the executive officers of Company A because it performs the audit of the broker and dealer. This interpretation essentially would result in the application of PCAOB independence rules to a large non-public entity based on an audit performed at a small broker and dealer component of that entity. If the parent company in this example were an issuer, then Rule 3523 would already apply to the issuer parent. While we acknowledge that the term "audit client" is a defined term under Rule 3501(a)(iv), we recommend that the Board clarify that Rule 3523 should be applied only to individuals in a financial reporting oversight role at the broker and dealer and should not extend to individuals in a financial reporting oversight role at the non-public parent company level.

Investigations and Adjudications (Section 5)

We support changes to the Board's rules to reflect its jurisdiction over the auditors of brokers and dealers. We note, however, that the Proposed Amendments include a number of changes, particularly regarding investigations and adjudications, that are unrelated to the Dodd-Frank Act. The Board has requested comment on whether these Proposed Amendments are clear and has also asked whether any additional changes should be made to the rules in Section 5. We believe that some of the Proposed Amendments are not clear, and in the interests of transparency and due process, we suggest that the Board consider whether these proposed changes can more meaningfully be considered as part of a separate rulemaking effort, which could also include suggestions for changes to the rules in Section 5 based on the experience of persons that have been the subject of informal inquiries and investigations.

1. ***Rule 5422(b), Documents That May Be Withheld*** – The Release proposes amendments to Rule 5422(b)(1)(i), which describes the documents that may be withheld from inspection and copying. Rule 5422(b)(1)(i) as currently written only excludes from production those documents that are, "prepared by a member of the Board or of the Board's staff." The Proposed Amendments would expand this exclusion significantly to also include documents prepared by persons retained by the Board or the Board staff, as well as any document "obtained from" the Board or Board's staff, or persons retained by the Board or its staff. The Proposed Amendments go well beyond the analogous SEC Rule.¹ We also note that to the extent that documents prepared by those retained by the Board or the Board's staff would include documents also subject to the privilege or work product exclusions described in current Rule 5422(b)(1)(ii), the Proposed Amendments could relieve the staff of its logging obligations pursuant to Rule 5422(c) if those documents are deemed to be withheld on the basis of a newly-expanded Rule 5422(b)(1)(i). The only explanation provided in the Release for these Proposed Amendments is that they are intended to "clarify" the scope of the current exclusion.

Moreover, the addition of Rule 5422(b)(1)(ii), which would permit the withholding of documents accessed from generally available public sources, could similarly affect the ability of a respondent to obtain documents which are relevant in a proceeding and which might, for example, either bear on the basis for claims being asserted against the respondent or be exculpatory of the respondent.

We note that these proposed changes could substantively expand the universe of documents which would not be available to a respondent for inspection and copying, as well as the conditions under which they could be withheld, and thus warrant a more thorough explanation of the intended purpose and discussion of the potential impact of the changes.

¹ See SEC Rule of Practice 230.



2. **Rule 5102(c)(3), Conduct of Examination, Persons to be Present** – During the comment process on the proposal and adoption of the PCAOB’s Section 5 Rules on Investigations and Adjudications, the Center for Public Company Audit Firms expressed concern about the exclusion of accountants from the list of persons who are permitted to be present when the Board’s staff conducts oral testimony during Board investigations.² Rule 5102(c)(3) provides that the persons who are allowed to be present during PCAOB investigative testimony are the witness, the witness’ counsel, any member of the Board or the Board’s staff, the reporter, and any other person whom the Board or the staff designated in the order of formal investigation determine are appropriate to permit to be present.

This rule does not expressly allow an accountant or other non-lawyer technical expert to assist the witness’ counsel in representation of the witness, despite the well-established practice of the SEC to allow an accountant to be present. The Adopting Release stated (at A2-18-19) that “[t]he rule provides sufficient flexibility for the staff to permit a technical consultant to be present during investigative testimony, and we expect the staff to allow that presence in appropriate circumstances and on appropriate terms, including, for example, that the consultant not be a partner or employee of the firm with which the witness is associated. We expect the staff to be accommodating, but we also expect the staff to be vigilant about not permitting a firm’s internal personnel effectively to monitor an investigation by sitting in on testimony of all firm personnel.”

It is our understanding that the Board’s staff does not permit counsel for a witness to be assisted by an accountant when their testimony is being taken where the accountant is an employee or partner of the firm. We continue to believe that this is inconsistent with the fact-finding purpose of the investigative process and contrary to relevant case law (*see* SEC v. Whitman, 613 F. Supp. 48 (D.D.C. 1985)).

Accordingly, we suggest that the Board reconsider and amend this Rule to expressly allow witnesses the right to counsel from accountants, particularly given the potentially complex nature of matters raised in Board investigations.

Registration and Reporting Forms

The Board is proposing to amend the Board’s registration, withdrawal and reporting forms to incorporate information relating to a firm’s audits of brokers and dealers. We generally are supportive of the amendments in this section but provide the following observations for the Board’s consideration:

1. **Form 1: Application for Registration** – The Note to Part III Item 3.3 states, “an applicant may presume...” while the Notes to Items 2.4 and 3.4d use the term “conclude” in the same context. We suggest that the PCAOB align the language in these three Notes.
2. **Form 2: Annual Report** – The Board has requested comment on whether firms should be required to report audit fee information for broker and dealer audit clients on an ongoing basis on Form 2. Since the PCAOB currently has access to fee information for registered firms, we believe that the ongoing administrative burden would outweigh any benefits of including fee information in Form 2.
3. **Form 3: Special Report Form**

Withdrawn broker and dealer audit reports – The proposed amendments require the auditor to file a Form 3 with the PCAOB in the event that the audit report of a non-issuer broker dealer is withdrawn. We

² See the Center for Public Company Audit Firms’ comment letter on the Securities and Exchange Commission (Release No. 34-49454; File No. PCAOB-2003-07); Public Company Accounting Oversight Board: Notice of Filing of Proposed Rules Relating to Investigations and Adjudications, April 15, 2004.



believe that it is important for the PCAOB and financial statement users to be aware of instances in which an audit report has been withdrawn. SEC regulations require issuers to report the withdrawal of the audit report, and PCAOB rules require the registered public accounting firm to report the withdrawal on Form 3 only if a timely Form 8-K is not filed by the issuer (i.e. on an exception basis). We believe that a similar approach for reporting withdrawn broker and dealer audit reports would be appropriate. We suggest that the SEC and the Board collaborate in the development of a mechanism for broker and dealer reporting of the withdrawal of audit reports, supplemented by Form 3 reporting by the registered audit firm on an exception basis. In the interim, we believe that PCAOB Interim Standard AU 561, Subsequent Discovery of Facts Existing at the Date of the Auditor's Report, provides a mechanism for auditors to notify users if an audit report is withdrawn.

Issuer auditor changes – Page 44 of the Release states that “[t]he Board believes a risk is posed when an issuer (including the issuer's significant subsidiaries) decides to change auditors and the issuer does not comply with the Commission's reporting requirements concerning the change in auditors.” As a result, the Board has proposed to amend Form 3 to require registered firms to file a special report with the Board if the firm resigns, declines to stand for re-appointment, or is dismissed from an issuer audit engagement and the issuer fails to file a required report with the SEC.

The Board has also requested comment on whether it is appropriate to amend the SECPS membership requirement that registered firms (that are former members of the SECPS) notify the SEC's Office of the Chief Accountant (OCA) of the cessation of an auditor's relationship with an issuer audit client by the end of the fifth business day after the firm determines that the client-auditor relationship has ended, irrespective of whether or not the issuer has reported the change in auditors in a timely SEC Form 8-K filing (a “five-day” letter).

The proposed requirement for registered public accounting firms to report on Form 3, on an exception basis, when issuers fail to file the required Item 4.01 Form 8-K, appears redundant to the existing SECPS reporting requirement to file the five-day letter with the SEC's OCA. We suggest that the SEC and the Board collaborate in the development of a single solution for reporting auditor changes.

In addition, Item 3.3c of Form 3 would require the auditor to state whether or not the audit committee recommended or approved the change in audit firm in instances where the firm has resigned, declined to stand for re-appointment, or been dismissed from an audit engagement, and the former client is an issuer and the issuer has failed to file a Form 8-K. This requirement should be limited to situations where the auditor has been dismissed, because the audit committee is not required to approve or disapprove the auditor's decision to resign or not stand for re-appointment.

Lastly, Item 3.3d diverges from the SEC's rule governing disclosure of changes in auditors. For example, the term “disagreements” is not defined in Item 3.3d, but guidance as to its meaning is provided in the SEC's rules.³ To minimize confusion in the application of the requirements related to changes in auditors, we encourage the PCAOB to conform the Item 3.3 requirements to the related SEC rules, either by specifically tracking the language or by making a cross-reference to the SEC rule.

Effective Date and Transition

The Board has indicated it will delay the date of required compliance with the Proposed Amendments to Rules 3521 through 3526 until the SEC determines that the PCAOB auditing, attestation, and related professional practice standards should govern the preparation and issuance of audit reports to be included in broker and dealer filings with the SEC. We suggest that the Board consider a sufficient transition period to

³ See Item 304 of Regulation S-K (Instruction 4).



minimize the implementation challenges associated with applying PCAOB rules and standards to the audits of brokers and dealers. We understand from the SEC staff that the SEC intends to amend Rule 17a-5 for audits of years ending December 31, 2012. If the amendment to Rule 17a-5 is not released until late in calendar 2012, we suggest that the Board consider a 2013 effective date for the Amendments to Rules 3521 through 3526 as they pertain to brokers and dealers. In our view, it will be particularly important to provide a sufficient transition period for any rule changes related to Rule 3523. We believe that the transition period utilized when Rule 3523 was originally adopted (and subsequently amended) for issuers would be appropriate.⁴

We appreciate the opportunity to comment on the Board's Proposed Amendments and welcome the opportunity to respond to any questions regarding the views expressed in this letter.

Sincerely,



Cynthia M. Fornelli
Executive Director
Center for Audit Quality

cc:

PCAOB

James R. Doty, Chairman
Lewis H. Ferguson, Board Member
Jeanette M. Franzel, Board Member
Jay D. Hanson, Board Member
Steven B. Harris, Board Member
Martin F. Baumann, Chief Auditor and Director of Professional Standards

SEC

Mary L. Schapiro, Chairman
Luis A. Aguilar, Commissioner
Daniel M. Gallagher, Commissioner
Troy A. Paredes, Commissioner
Elisse B. Walter, Commissioner
James L. Kroeker, Chief Accountant
Brian T. Croteau, Deputy Chief Accountant
J. W. Mike Starr, Deputy Chief Accountant
Paul Beswick, Deputy Chief Accountant
Michael A. Macchiaroli, Associate Director, Office of Risk Management & Control, Division of Trading and Markets

⁴ See PCAOB Release No. 2005-014. That transition rule was subsequently amended. See PCAOB Release No. 2006-001.



CENTER FOR AUDIT QUALITY

1155 F Street NW, Suite 450, Washington, DC 20004, (202) 609-8120 www.thecaq.org