

# ABA

AMERICAN BAR ASSOCIATION

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September 19, 2007

**via e-mail to:comments@pcaobus.org**

Public Company Accounting Oversight Board

Attention: Office of the Secretary

1666 K Street, N.W.

Washington, DC 20006-2803

**Re: PCAOB Rulemaking Docket Matter No. 017  
Proposed Ethics and Independence Rule 3526, Communication with Audit  
Committees Concerning Independence, etc.**

Ladies and Gentlemen:

This letter is submitted on behalf of the Committees on Federal Regulation of Securities and Law and Accounting (the “Committees”) of the Section of Business Law of the American Bar Association in response to the request for comments by the Public Company Accounting Oversight Board (the “Board”) in its July 24, 2007 proposal referenced above (the “Proposal”).

The comments expressed in this letter represent the views of the Committees only and have not been approved by the American Bar Association’s House of Delegates or Board of Governors and therefore do not represent the official position of the American Bar Association (the “ABA”). In addition, this letter does not represent the official position of the ABA Section of Business Law, nor does it necessarily reflect the views of all members of the Committees.

The Board proposes to adopt a new Rule 3526, which would, *inter alia*, 1) require a registered public accounting firm, prior to accepting an initial engagement, to provide written disclosures to the audit committee of the potential client of relationships that may reasonably be thought to bear on the independence of the registered accounting firm and to discuss the potential effects of these relationships on independence, and 2) require the registered public accounting

firm to provide similar communications on an annual basis.<sup>1</sup> The new rule would supersede *Independence Standards Board Standard No. 1, Independence Discussions with Audit Committees* (“ISB No. 1”), and two related interpretations.

The Committees generally support proposed Rule 3526. As the Board’s Release indicates, the proposed pre-engagement rule fills a gap in current ISB No. 1, which does not require a firm to provide disclosures to or engage in discussions with audit committees about independence prior to acceptance of the initial engagement.<sup>2</sup> Obviously, because independence is a prerequisite to a firm’s ability to render an audit report, it is a critical matter for the firm and the audit committee to consider before agreeing to an engagement. In light of that, we believe that accounting firms already communicate to audit committees about independence matters in connection with potential engagements of a registered public accounting firm. Therefore, the proposed rule for pre-engagement independence disclosures and discussions should not materially alter current practice. The requirement for annual disclosures and discussions largely codifies ISB No. 1.

We do wish to comment on one question posed by the Board in its release. The Board asks: “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 Committees believe that the Rule should contain a defined look-back period that would limit the relationships that would have to be disclosed to and discussed with the audit committee.

The purpose of the independence rules, of course, is to ensure that the accounting firm is independent with respect an audit report that it has been engaged to render. Independence could be affected by relationships that existed in periods prior to the current audit and engagement period. However, the further one goes back in time the less likely past relationships will be thought to bear on the current independence of the accounting firm. At the same time, the definitions of “accounting firm” and “audit client” in the SEC’s independence rules are broad. Therefore to identify all potential relationships could involve substantial effort by the accounting firm.<sup>3</sup> At some point the effort required to develop the information about relationships in the

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<sup>1</sup> The Board also proposes to amend Rule 3523, *Tax Services for Persons in Financial Oversight Roles*. The Committees believe that the proposed amendments are appropriate but otherwise do not comment on the proposed Rule 3523.

<sup>2</sup> ISB No. 1 does require communications with the audit committee prior to a company’s initial public offering.

<sup>3</sup> See Regulation S-X, Rule 2-01(f)(1) (defining “accounting firm” to include “all of the organization’s departments, divisions, parents, subsidiaries and associated entities, including those located outside of the United States”); Rule 2-01(f)(4) (defining “audit client” to include “the entity whose financial statements or other information are is being audited, reviewed or attested and any affiliates of the audit client,” subject to certain exceptions); Rule 2-01(f)(6) (defining “affiliate of the audit client” to include an entity that has control over, is controlled by or is under common control with, the audit client; an entity over which the

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past and to discuss that information with the audit committee outweighs the value to the audit committee in being informed about such relationships. A specific look back can focus the accountants and the audit committee on those relationships that are most likely to be relevant to ascertaining whether the accounting firm is independent for purposes of the current audit.

Based on the foregoing, we believe that a look-back period of no longer than two years prior to the commencement of the audit period for which the accounting firm will be engaged should be sufficient to enable the accounting firm to identify relationships that should be communicated to the audit committee. Older relationships are unlikely, in our view, to raise issues that will bear on an assessment of the auditor's current independence.<sup>4</sup>

In addition to the foregoing, we suggest the following:

1. The Board should reconsider its proposal not to include the phrase "in the auditor's professional judgment," which presently appears in ISB 1, in the standard for determining what matters might reasonably be thought to bear on independence. We think it is reasonable and appropriate for audit committees to rely on the accounting firm's judgment as to what matters should be disclosed, and that it is not necessary to adopt an objective reasonableness standard for assessing whether the accountants have disclosed relevant matters.

2. The Board should consider modifying proposed Rule 3526(a)(1) and (b)(1) to provide that the relationships to be disclosed in writing are those that may be thought to bear on independence "as of the date of the writing." This would make it clear that the matters affecting independence would be assessed as of the date of the communication and do not have to include matters that might have affected independence in the past.

We appreciate the opportunity to provide these comments. Members of the Committees are available to discuss them should the Board or the staff so desire.

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audit client has "significant influence" unless the entity is not material to the audit client, or an entity which has significant influence over the audit client, unless the audit client is not material to that entity).

<sup>4</sup> Our comments should in no way be construed as suggesting that accounting firms must perform more diligence about independence that they presently do or that they are required to look back for a longer time than they currently deem to be necessary.

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Respectfully submitted,

/s/ Linda L. Griggs

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Linda L. Griggs, Chair of the Committee  
on Law & Accounting

/s/ Keith F. Higgins

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