July 24, 2006

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

Re: PCAOB Rulemaking Docket Matter No. 019: Proposed Rules on Periodic Reporting by Registered Public Accounting Firms

Members and Staff of the Public Company Accounting Oversight Board:

The American Institute of Certified Public Accountants (AICPA) respectfully submits the following written comments on the Public Company Accounting Oversight Board's (the PCAOB or the Board) Proposed Rules on Periodic Reporting by Registered Public Accounting Firms (the Proposed Rules).

The AICPA is the largest professional association of certified public accountants in the United States, with more than 340,000 members in business, industry, public practice, government and education. The comments in this letter represent the views of those members who audit public companies.

The AICPA recognizes the extensive efforts made by the PCAOB's members and staff to implement the provisions of the Sarbanes-Oxley Act of 2002. As part of that effort, the Board has proposed rules to establish periodic and special reporting requirements for registered public accounting firms (RPAFs). The AICPA is committed to working with the PCAOB to develop fair and effective reporting requirements that satisfy the Board's need for current and relevant information about RPAFs and their public company audit practices. To that end, we appreciate the opportunity to comment on the Proposed Rules.

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General Comments

Overall, we support the Proposed Rules and recognize the Board's interest in obtaining from RPAFs, on an annual basis, basic information that updates information in a firm's Form 1 registration statement and assists the Board in planning for firm inspections. We also support the Board's proposal to adopt special reporting requirements that would require RPAFs promptly to bring significant, non-routine events to the Board's attention. However, we have identified a

number of issues with the Board's proposed Form 2 annual report and Form 3 special reports that we believe warrant further consideration and clarification by the Board.

As a preliminary matter, our overarching comment is that, as currently drafted, several of the Proposed Rules are considerably broader in scope than the comparable provisions included in the Form 1 registration requirements and would impose a greater compliance burden on RPAFs than the Board may have intended. Specifically, in the release that accompanied the Proposed Rules, the PCAOB emphasized that the Proposed Rules were not intended to impose unnecessary burdens on RPAFs and suggested that compliance with the proposed requirements would not entail significant effort or cost.[1] It is our understanding, however, that many RPAFs do not have available certain of the required information in the specific format contemplated by the Proposed Rules and that the costs involved in generating that information would be significant.

Accordingly, we respectfully request that the Board allow more flexibility with respect to the manner in which RPAFs report on certain categories of information, as described in more detail below with respect to specific items of proposed Form 2 and Form 3. In making the following comments, we have attempted to strike an appropriate balance between the Board's need, as it seeks to carry out its mandate, for current and timely information regarding RPAFs, and the potentially significant additional compliance costs that certain of the Board's proposals, as currently constructed, may impose on RPAFs.

Comments on Proposed Form 2 Annual Reports

Proposed Item 2.1 of Form 2 — Reporting Period

Proposed Item 2.1 would require each RPAF to file an annual report on Form 2 covering a 12-month period beginning April 1 and ending on March 31 of the following year. In addition, Proposed Rule 2201 would set June 30 as the deadline for RPAFs to prepare and file an annual report on Form 2. For the following reasons, we recommend that the Board amend proposed Item 2.1 to permit an RPAF to set its own 12-month reporting period — or at least allow a firm the option of using its own fiscal year as an alternative to the 12-month period ending March 31.

The Proposing Release acknowledges that an April 1 to March 31 reporting period would require many RPAFs to prepare information for a period other than their current fiscal year. Indeed, our understanding is that less than two percent of firms that audit public companies and whose views are represented in this letter currently operate on fiscal years ending March 31. However, the Board suggests in the Proposing Release that this requirement would not be unreasonable because "none of the information required by proposed Form 2 involves any complexity or burden * * *."[2] This simply is not the case. Several of the Proposed Rules would impose new reporting obligations on RPAFs, however, and the burdens of complying with those requirements

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[1] *See "*Proposed Rules on Periodic Reporting by Registered Public Accounting Firms," PCAOB Release No. 2006-004 (May 23, 2006) (the "Proposing Release") at 2 and 8.

[2] Proposing Release at 8.

would be significant for some firms. For example, although practices may vary depending on the size of an accounting firm and the nature of its audit practice, we understand that while many RPAFs can extract this information at any one point in time, the cost and complexity of doing so in the specific format requested and at a period other than the firm's fiscal year end (which may not be March 31) or some other 12-month period of the RPAF's choosing significantly increases the cost without a corresponding increase to the benefits derived from gathering this specific information. Many RPAFs do not specifically track, and could not readily generate for a 12-month period ending March 31, the specific information required under several proposed Form 2 items, including:

- Item 3.2 (requiring RPAFs to provide certain fee-related data on a percentage basis);
- Item 4.1.b (requiring RPAFs to identify the total number of personnel who exercised authority to sign audit reports during the reporting period); and
- Item 6.1 (requiring RPAFs to report, among other things, the total number of a firm's personnel who provided audit services to issuers during the reporting period, segregated by functional level).

As we discuss in our specific comments, we believe that firms should be allowed to report information on certain of these items using ranges or estimates. Moreover, in many cases, we believe that it would be less burdensome for an RPAF to retrieve and process the information required by proposed Form 2 based on the firm's existing internal information tracking systems, which may be tied to the firm's fiscal year. In our view, this more flexible approach would enhance, rather than detract from, the quality and accuracy of the information reported to the Board. Moreover, this recommendation is consistent with the SEC's approach to regulating public companies, which are permitted to select their own fiscal years for periodic reporting purposes.

Proposed Item 3.2 of Form 2 — Firm Revenues

Proposed Item 3.2 would require an RPAF to state, for the period April 1 to March 31, the percentage of total fees billed by the RPAF to all clients for services rendered that were attributable to fees billed to issuer audit clients for "audit services," "other accounting services," "tax services," and "non-audit services." We have two comments on this proposal. First, we suggest that the Board clarify that the designated fee categories are identical to similar terms used in the SEC's proxy disclosure rules. Second, we recommend that the Board adopt a more flexible approach regarding the manner in which RPAFs calculate and report the required fee information.

With respect to the fee categories in proposed Item 3.2, we understand that they are intended to correspond to the four categories identified in the SEC's proxy disclosure rules, which require

issuers to report the amounts paid to the issuer's principal accountants. However, the terms "audit services," "other accounting services," "tax services," and "non-audit services" differ from the terms used by the SEC's proxy disclosure rules, which refer to "audit fees," "audit-related fees," "tax fees," and "all other fees." To avoid any potential confusion caused by the different wording and the slight variation in the corresponding definitions, we suggest that the Board either amend its defined terms to match the terms used in the SEC's proxy disclosure rules or expressly state in a note accompanying Item 3.2 that the PCAOB intends the terms to be identical to the terms used in Item 9(e) of the SEC's Schedule 14A.

In addition, we understand that RPAFs generally do not collect fees or aggregate fee information in a manner that would allow them readily to respond to proposed Item 3.2. Specifically, to the extent such information is collected, RPAFs do not maintain and calculate this information for all of their issuer clients over the proposed reporting period (*i.e.*, April 1 to March 31). Rather, RPAFs currently provide their issuer clients with the aggregate fees billed for professional services during the *issuer's* fiscal year. In addition, the fee information provided to the issuer includes services rendered by all of the RPAF's departments, divisions, parents, subsidiaries, and associated entities that provide professional services to the issuer, including those located outside of the United States (consistent with the definition of "principal accountant," as that term is used in the SEC's proxy disclosure rules).

Accordingly, to provide the percentages required by proposed Item 3.2, an RPAF would be required (1) to calculate fees over a period that is normally inconsistent with both the issuer's fiscal year and the RPAF's fiscal year, and (2) to perform additional calculations to make sure that fees attributable to the associated entities and foreign affiliates of the RPAF were not included — which would essentially reconcile the difference between an "RPAF" and a "principal accountant." Depending on the specific facts and circumstances of a particular RPAF, such calculations could be a significant, time-consuming and costly undertaking.

We recognize the Board's interest in obtaining "a picture of how the firm's services for issuer audit clients compare generally with the firm's services for other clients," as well as "a picture of the allocation of services the firm provided to issuer audit clients."[3] We also believe that this interest must be balanced against the burdens involved in calculating the precise fee information as contemplated by proposed Item 3.2. In balancing these interests, we believe that the Board can obtain the information it is looking for under a more flexible approach. To that end, we offer the following two suggestions:

First, we believe that the Board should allow an RPAF to develop its own methodology for calculating the percentage of estimated total billings that are attributable to each of the four fee categories. Under this proposed approach, an RPAF would be required to submit to the Board the methodology used to calculate the percentages. As long as the stated methodology is reasonable, the RPAFs would not be limited to any specified 12-month reporting period.

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[3] Proposing Release at 4.

Moreover, since the Board presumably is interested in fee information of a directional nature, rather than precise data, the burdens of performing a precise calculation could be alleviated by allowing RPAFs to report the percentages of fees for issuer clients attributable to the four fee categories through the use of ranges (*e.g.,* 0% - 10%, 11% - 20%, etc.).

In the alternative, we propose that the Board adopt an approach whereby RPAFs are expressly permitted to calculate the relevant percentages by relying on information that is already available. Specifically, RPAFs could use the most recent proxy data published by each of its issuer clients and aggregate the fee information in those filings for each of the four categories. In using this data, an RPAF would need to exclude fees for services rendered by certain of the firm's associated entities that were not part of the RPAF, but nevertheless fell within the SEC's definition of a "principal accountant." While this method will result in a calculation that is based on information from different time periods, the fee information reported would still be relevant and instructive for the Board's purposes, as it would reflect work the RPAF performed for its issuer clients during the issuers' most recent fiscal years. In addition, as with the first proposal, the burdens of performing a precise calculation could be alleviated by requiring RPAFs to report the fee information through the use of ranges (*e.g.,* 0% - 10%, 11% - 20%, etc.).

Accordingly, we recommend that the Board amend proposed Item 3.2 to allow for more flexibility and offer the two proposals outlined above for the Board's consideration. While the proposed alternatives would not yield precise results, they would provide the Board with reasonable estimates that we believe should satisfy the Board's informational goals.

Proposed Item 4.1 of Form 2 — Audit Reports Issued by the Firm

Under proposed Item 4.1.a.3, if an RPAF issued an audit report for an issuer during the period April 1 to March 31, the RPAF would be required to identify the dates of each audit report issued for that issuer during the 12-month reporting period. It is our understanding that many RPAFs do not currently track this information in a manner that would allow them readily to respond to this item. While we recognize the Board's desire for information regarding an RPAF's issuance of audit reports for issuers, we believe that proposed Items 4.1.a.1 and 4.1.a.2 should satisfy the Board's needs. These items would require an RPAF to provide the names and CIK numbers of every issuer for which the RPAF issued an audit report during the reporting period.

In comparison, it is not clear why the Board would routinely need the dates of every audit report issued by an RPAF for every issuer, including separate audit reports and dual-dated audit reports. Given the costs of establishing a tracking system to collect this information, we suggest that the Board eliminate proposed Item 4.1.a.3. As stated above, however, if the Board determines to adopt this requirement, we recommend that the Board permit an RPAF to report the requested information based on its own fiscal year, or some other annual period of the RPAF's choosing.

In addition, under proposed Item 4.1.b, if an RPAF issued an audit report for any issuer during the period April 1 to March 31, the RPAF would be required to provide the total number of its

personnel who exercised the authority to sign the RPAF's name to an audit report during the reporting period. We believe the Board's need for general information related to the number of personnel within a firm who possessed or exercised the authority to sign audit reports can be satisfied without requiring such precise data. Accordingly, we recommend that the Board allow RPAF's to report the total number of personnel who exercised the authority to sign the RPAF's name to an audit report through the use of ranges (*e.g.,* 1-10; 11-50; 51-100, etc.). In addition, we believe that firms would find such a reporting requirement less burdensome if the Board allowed them to track and report the data based on their own fiscal years, or some other 12-month period of their choosing.

Proposed Item 5.2 of Form 2 — Audit-Related Members, Affiliations, or Similar Arrangements

Proposed Item 5.2.a.3 of Form 2 would require an RPAF to report any "affiliation" with another entity through which the firm "commonly employs or leases personnel to perform audit services . . . ." There are a number of circumstances where an RPAF, particularly a small firm, might contract with a third-party entity to provide a variety of audit services, including valuation or actuarial services in support of an audit engagement or serving as a concurring review partner. However, the mere fact that an RPAF frequently contracted with a third party to provide services or additional personnel to assist with audit engagements would not mean that the RPAF and the third party were "affiliates," as that term is commonly understood. Accordingly, we submit that this requirement is unclear and that the Board should more specifically define what the term "affiliation" is intended to mean in this context. In addition, we submit that the phrase "commonly employs or leases" is unclear, and likely would be interpreted differently by different firms, and that the Board should clarify its intended meaning.

Proposed Item 6.1 of Form 2 – Number of Firm Personnel

Proposed Item 6.1.d would require an RPAF to identify the total number of the firm's personnel who were employed by the firm at the end of the reporting period and, during the period April 1 to March 31, had provided audit services to issuers, "segregated by functional level." A note accompanying proposed Item 6.1 states that the total number of personnel who provided audit services should be reported separately for different levels of responsibility, such as partners, senior managers, managers, and audit staff. It is our understanding that many RPAFs do not track personnel and their audit-related responsibilities for issuers in a manner that would allow them to respond to this item without incurring a substantial burden.

Accordingly, we recommend that the Board adopt a more flexible approach in requiring the reporting of this type of information. Specifically, we believe that the Board should permit firms to report these figures using ranges of personnel for various "functional levels" (*e.g.,* 1-10; 11-50; 51-100, etc.). In addition, we believe that firms would find such a reporting requirement less burdensome if the Board allowed them to track and report the data based on their own fiscal years, or some other 12-month period of their choosing.

Proposed Item 7.1 of Form 2 – Certain Sanctioned Individuals

Proposed Item 7.1 would require an RPAF to disclose whether, during the relevant reporting period, it had taken on as an employee, partner, shareholder, principal, or member, or otherwise become owned or partly owned by, an individual who, within the last five years, was the subject of either a PCAOB disciplinary sanction or a sanction under Rule 102(e) of the SEC's Rules of Practice. We recommend that the Board harmonize proposed Item 7.1 of Form 2 with Item 5.1 of Form 1, the analogous provision in the Board's registration application, by limiting the contemplated disclosure requirement to situations in which the previous PCAOB or SEC disciplinary proceeding arose out of the individual's conduct in connection with an audit report or comparable report prepared for a non-issuer client. We also believe that the Board should consider limiting the scope of Item 7.1 to individuals who would be assuming senior management positions within an RPAF or were being hired to perform audit services. Finally, we submit that the Board should eliminate, or significantly limit, the proposed requirement that RPAFs report such information on a "catch-up" basis in their first Form 2.

With respect to our first suggestion, Item 5.1 of Form 1 contains an analogous requirement that a firm disclose certain pending or resolved administrative or disciplinary proceedings against the firm or its associated persons. The analogous provision under Item 5.1, however, is limited to proceedings that arose out of the firm's or the associated person's "conduct in connection with an audit report or comparable report prepared for a non-issuer client." In comparison, proposed Item 7.1 would require an RPAF to disclose employment relationships that were not required to be disclosed under Form 1, and to report certain disciplinary sanctions that may be completely unrelated to the preparation of an audit report, whether for an issuer or a non-issuer. We believe that the resources dedicated to monitoring and reporting certain sanctions to the PCAOB should be directed to issues that relate more directly to an RPAF's audit practice. Accordingly, we recommend that the Board amend the scope of proposed Item 7.1 to conform to Item 5.1 of Form 1.

In addition, we believe that, particularly given its broad scope, proposed Item 7.1 would have collateral consequences that the Board may not have anticipated with respect to the employment prospects of individuals whose sanctions were required to be disclosed. Many RPAFs may be reluctant to hire an individual, regardless of the nature of the position sought by the individual, if the employment relationship had to be disclosed separately on Form 2. In many cases, the mere requirement to make such a disclosure might weigh heavily against hiring the individual, notwithstanding the relative merits of the applicant. We believe that such potential consequences are too severe in the context of individuals who are not applying for senior management positions and/or who are not being hired to work on audits. Moreover, even if the individual was hired by the RPAF, the disclosure obligation would, in essence, constitute a "re-publication" of the prior sanction, which we believe would be unfair. The broad application of proposed Item 7.1 also might dissuade individuals who become involved in PCAOB or SEC investigations or proceedings from settling with regulators in light of the potential collateral consequences. Thus,

we recommend that proposed Item 7.1 be limited to individuals who are hired in senior management positions within the RPAF and/or hired to perform audit services.

Moreover, with respect to the first annual report that an RPAF would file, the Board would require an RPAF to provide information under Item 7.1 for the period running from the date used by the RPAF for registration purposes (*i.e.*, no earlier than 90 days prior to the submission of the application for registration) through March 31 of the year in which the first annual report is filed. As such, this "catch-up" reporting would create a potentially onerous obligation to track down and report on any individual who had been employed by the RPAF during the "catch-up" period and had been the subject of a PCAOB or SEC disciplinary proceeding, without regard to the nexus, if any, to the RPAF's preparation of audit reports for issuers or whether the individual is still employed by the RPAF. We believe that the Board should eliminate the "catch-up" reporting requirement or significantly limit its scope to apply to a narrower set of individuals than would be subject to the general proposed Item 7.1 reporting requirement. Specifically, if the Board determines to adopt a "catch-up" provision, we believe that it should apply only to persons (1) who were hired in senior positions to perform audit services and (2) who were still employed by the RPAF at the relevant "cut-off date" for the Form 2 filing. Similar burdens associated with the proposed "catch-up" reporting requirement also are noted below in connection with several other comments.

Proposed Item 7.2 of Form 2 — Individuals Connected with Certain Sanctioned Firms

Proposed Item 7.2 would require an RPAF to disclose whether, during the relevant reporting period, it had hired or become owned or partly owned by an individual who had been a partner, shareholder, principal, member, or proprietor of a public accounting firm that had been subject to certain sanctions imposed by the PCAOB or SEC within the last five years (a "Sanctioned Firm"). This disclosure requirement would be triggered if the newly hired individual served as a partner, shareholder, principal, member, or proprietor at a Sanctioned Firm "at a time of the conduct" giving rise to the PCAOB or SEC sanction.

For the reasons discussed above in connection with proposed Item 7.1, we believe that a reporting requirement of this nature would have collateral consequences in connection with the subsequent hiring of individuals previously associated with a Sanctioned Firm. Indeed, proposed Item 7.2 would require public disclosures by an RPAF, even in situations where the individual played no role in the conduct giving rise to the sanction against his or her prior firm. We do not believe the Board should impose a reporting requirement that might discourage an RPAF from hiring an otherwise qualified individual, even if the individual played no role in the conduct giving rise to the sanction, simply because he or she previously has been associated with a Sanctioned Firm.

In addition, we believe that RPAFs would find it difficult to ensure compliance with proposed Item 7.2, as drafted. The timing of a sanction imposed on an entity is rarely contemporaneous with the underlying conduct. In many cases, months, if not years, might pass before the SEC or

PCAOB imposed a disciplinary sanction on an individual's prior firm. By that time, the individual may have moved on to one or more other firms before the sanction was publicly announced. Under proposed Item 7.2, however, an RPAF would not only have to determine whether an applicant was employed by a Sanctioned Firm at the time of his or her hiring, but also evaluate and monitor the subsequent disciplinary status of his or her prior firms over an extended period.

A requirement that an RPAF disclose this information on a "catch-up" basis in its first Form 2 report would substantially increase the reporting burdens for RPAFs, as a firm would have to evaluate the disciplinary history of the former employers of a potentially large pool of individuals hired since the firm filed its Form 1 registration application. Accordingly, as with our prior comment regarding proposed Item 7.1, we recommend that the Board eliminate the "catch-up" reporting requirement or significantly limit its scope to apply only to a narrower set of individuals than would be subject to the general proposed Item 7.2 reporting requirement. Specifically, if the Board determines to adopt a "catch-up" provision, we believe that it should apply only to persons (1) who were hired in senior positions to perform audit services, and (2) who were still employed by the RPAF at the relevant "cut-off date" for the Form 2 filing.

Proposed Item 7.4 of Form 2 — Certain Arrangements to Receive Consulting or Other Professional Services

Proposed Item 7.4 would require an RPAF to disclose whether it had entered into a "contractual or other arrangement to receive consulting or other professional services" from (1) certain sanctioned individuals described in proposed Item 7.1.a, (2) individuals connected with certain sanctioned entities described in proposed Item 7.2.a, or (3) certain sanctioned entities described in proposed Item 7.3.a. We submit that the Board should limit the scope of proposed Item 7.4 to apply only to those individuals and entities that enter into contractual or other arrangements with the RPAF to provide services in connection with the issuance of an audit report for issuer audit clients. In addition, we believe that the Board should eliminate, or significantly limit, the "catch-up" reporting requirements for this information.

This proposed item would appear to require RPAFs to evaluate and monitor the disciplinary histories of individuals and entities that provided a wide range of consulting or other professional services to RPAFs. For example, RPAFs would be required to track the disciplinary histories of information technology consultants and other independent contractors who had previously provided, or were currently rendering, services unrelated to a firm's issuer audit practice, as well as the disciplinary records of their employers and former employers that were public accounting firms. Moreover, Item 7.4 would apply to consultants and independent contractors retained by an RPAF, rather than to a firm's full-time employees. In many instances, firms might conduct only limited due diligence prior to retaining such consultants or contractors, given the limited nature of the relationship and taking into consideration the types of services the consultants or contractors were being hired to provide.

We believe that the Board has a legitimate interest in learning when an RPAF had retained a previously sanctioned individual or entity as an independent contractor or consultant to assist the firm with audits of issuer clients. Accordingly, we believe that the disclosure of such relationships in a Form 2 would be appropriate in these circumstances. However, we do not believe that the PCAOB should require RPAFs to monitor and report on contractors that have been retained to provide services unrelated to the firm's preparation of audit reports for its issuer audit clients.

In addition, for the reasons discussed above with respect to proposed Item 7.2, we believe that the imposition of such a reporting requirement might serve to discourage RPAFs from hiring otherwise qualified outside contractors and consultants. For example, as drafted, Item 7.4 would require an RPAF to make specific disclosures in situations where an independent consultant previously had held certain positions with a Sanctioned Firm, but personally had played no role in the conduct giving rise to the sanction against his or her prior firm.

As with proposed Items 7.1 and 7.2, a requirement that an RPAF disclose such information on a "catch-up" basis in its first Form 2 report would substantially increase the reporting burdens for RPAFs. Specifically, an RPAF would have to evaluate the disciplinary history of a potentially large pool of independent contractors and consultants retained since the firm filed its Form 1 registration application, as well as the disciplinary records of their employers and former employers that fell within the definition of a "public accounting firm." In many instances, RPAFs would not have this information readily available in their records and former consultants or contractors might decline to supply additional information regarding their prior employers to firms. Accordingly, we recommend that the Board eliminate the "catch-up" reporting requirement or significantly limit its scope to apply only to consultants and contractors who (1) were retained to assist with an RPAF's performance of audit services for issuers and (2) were still retained by the RPAF at the relevant "cut-off date" for the Form 2 filing.

Proposed Item 8.1 of Form 2 – Acquisition of Another Accounting Firm or Substantial Portions of Another Accounting Firm's Personnel

Proposed Item 8.1 would require an RPAF to state whether it had acquired another accounting firm or, without acquiring another accounting firm, taken on as employees, partners, shareholders, principals, members or owners 75% or more of the persons who were the partners, shareholders, principals, members or owners of another accounting firm. As proposed, this item would require RPAFs to disclose relatively insignificant acquisitions. For example, an RPAF that employs 1,000 or more accountants would be required to disclose the hiring, perhaps at different times, of three partners from a four-partner accounting firm.

In addition, the "catch-up" reporting requirement would mean that, with respect to the first annual report to be filed, an RPAF would bear the burden of tracking down and reporting whether during the catch-up period any combination of newly hired persons constituted 75% or more of the persons who were partners, shareholders, principals, members, or owners of another

accounting firm. Indeed, this requirement would appear to apply even if some or all of those persons were no longer employed by the RPAF at the time of the cut-off date for the Form 2 report.

We believe that the Board should limit the scope of proposed Item 8.1 to the disclosure of significant acquisitions. At a minimum, the Board should include an exception for *de minimis* acquisitions. In addition, to determine the significance of an acquisition, the Board might employ a framework similar to Rule 3-05 of Regulation S-X, which establishes a standard by which public companies determine whether to file the financial statements of businesses acquired or to be acquired. We also submit that the Board should eliminate the "catch-up" reporting requirements with respect to Item 8.1, particularly if the Board does not limit its scope to significant acquisitions.

Comments on Proposed Form 3 Special Reports

Proposed Rule 2203 – Special Reports

Proposed Rule 2203 would require an RPAF to file a special report on new Form 3 within 14 days of the occurrence of certain specified events. We recognize that the purpose of Form 3 reporting is to alert the Board to the occurrence of certain non-routine events that may "have somewhat more immediate bearing on how the Board carries out its regulatory responsibilities regarding the firm."[4] Based on input from a number of our member firms, however, we are concerned that the proposed 14-day deadline would not, in many cases, provide sufficient time for RPAFs to gather information regarding potentially reportable events, evaluate that information, and report those events in a meaningful and comprehensive way. Complying with this deadline would be particularly difficult in situations where the disclosure requirement is triggered by the conduct of an individual (or an individual's prior employer), rather than by the RPAF's conduct.

Accordingly, we recommend that the Board amend proposed Rule 2203 to allow RPAFs to file a Form 3 within 45 days of a reportable event. By way of analogy, some state boards of accountancy typically allow firms subject to their jurisdiction 45 days to report significant events.

The "Firm Has Become Aware" Standard

Proposed Items 2.4 through 2.10, 2.14, and 4.1 of Form 3 would require an RPAF to file a special report with the Board if the "[f]irm has become aware" that certain events have occurred. We believe that this standard is vague as to when knowledge by persons employed by an RPAF will be ascribed to the firm for Form 3 reporting purposes. We suggest that the Board amend each of the proposed items noted above to make clear that a reporting obligation is triggered if

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[4] *Id.* at 3.

specified senior personnel at the RPAF (*e.g.*, the firm's governing board and/or its senior management) have actual "knowledge" of the event.

Specifically, under the proposed items, an RPAF's reporting obligation arguably might be triggered if *any* partner or employee of the RPAF became aware of a reportable event. Coupled with the fact that RPAFs would have only 14 days to file a Form 3 under proposed Rule 2203, circumstances could be expected to arise in which firms inadvertently failed to make a timely Form 3 filing, due to a lack of knowledge of the reportable event by persons at the firm charged with responsibility for preparing Form 3 filings or a delay in communicating information to such individuals.

To reduce this risk, we believe that more senior personnel of the RPAF should have knowledge of an event before the RPAF is required to report the event on Form 3. By way of analogy, we suggest that the Board consider Item 5.01(a) of the SEC's Form 8-K, which requires registrants to report a change in control of the registrant if, "to the knowledge" of the registrant's board of directors, a committee of the board of directors or authorized officers of the registrant, such an event has occurred. In making this suggestion, we are mindful that, regardless of whether the Board adopts an "awareness" or "knowledge" standard, each RPAF should establish internal processes to encourage the communication of accurate and prompt information regarding potentially reportable events to the proper individuals within the firm, so that the firm is able to confirm and report these events in a timely manner.

The Definition of "Manager"

Items 2.6, 2.8, 2.9, 5.1, and 5.2 of proposed Form 3 refer to the term "manager" in the context of various reporting obligations that would be triggered if an RPAF became aware that a "partner, shareholder, principal, owner, member, or *manager*" of the RPAF was connected to certain pending or concluded legal proceedings. The terms "partner," "shareholder," "principal," "owner" and "member" are generally understood to refer to persons who have an ownership interest in an RPAF. In contrast, while the term "manager" generally does not refer to an individual with an ownership interest in an RPAF, it is not defined in the Board's rules and may refer to employees at varying levels of seniority, depending on a particular firm's structure and terminology. Accordingly, we request that the Board clarify the intended meaning of the term "manager" in these items.

Proposed Items 2.1 and 3.1 of Form 3 – Withdrawn Audit Reports and Consents

Proposed Item 2.1 would require an RPAF to report to the Board any circumstances in which (1) it had withdrawn an audit report on financial statements, or withdrawn its consent to the use of the RPAF's name in a report, document, or written communication containing the issuer's financial statements, and (2) the issuer had failed to comply with an SEC requirement to make a timely report concerning the matter pursuant to Item 4.02 of Form 8-K.

We understand that the Board's goal in proposing Items 2.1 and 3.1 was to highlight instances where an issuer may have failed to comply with Item 4.02(b) of Form 8-K and create a new vehicle to notify the public of such situations. We strongly support regulatory efforts to ensure that issuers comply with their Form 8-K and other reporting obligations. However, we do not believe that requiring RPAFs to report to the Board, which has no authority over issuers, potential violations of selected Form 8-K requirements by their issuer audit clients is an appropriate means to accomplish that objective. Establishing issuer reporting requirements and enforcing compliance with those requirements is the province of the SEC. We respectfully submit that the Board should leave this issue to the discretion of the SEC and remove proposed Items 2.1 and 3.1 from proposed Form 3.

Proposed Items 2.4 and 4.1 of Form 3 – Unauthorized Use of Firm Name

Proposed Items 2.4 and 4.1 would require an RPAF to indicate whether it had become aware that an issuer, in a report, document or written communication containing an issuer's financial statements had used the RPAF's name without the RPAF's consent in circumstances where such consent was required or the issuer had indicated that such consent was provided.

We agree with the Board that an issuer's unauthorized use of an RPAF's name may be cause for concern for the RPAF and the investing public. However, similar to our comments in connection with proposed Items 2.1 and 3.1, proposed Items 2.4 and 4.1 involve issuer misconduct, which we believe should be addressed by the SEC.

If, however, the PCAOB decides to impose a reporting obligation on RPAFs in such circumstances, we suggest that the Board limit the disclosure obligation to apply only to the unauthorized use of a firm's name in an audit report. As currently drafted, Items 2.4 and 4.1 would apply broadly to any unauthorized use of an RPAF's name in "a report, document, or written communication containing the issuer's financial statements" and, therefore, could be triggered by an unauthorized reference to a firm in a document prepared or distributed by an issuer that is not an audit client. For example, the reporting obligation under these proposed items would be triggered if an issuer that was not an RPAF's audit client hired the firm to provide M&A-related services and subsequently referenced the firm's work, without the firm's consent and contrary to the terms of the firm's engagement letter, in a document that also contained the issuer's financial statements.

Therefore, if the Board decides to adopt Items 2.4 and 4.1, we believe that it should limit those requirements to the unauthorized use, by an issuer, of an RPAF's name in an audit report. By doing so, the Board would address situations that directly relate to the RPAF's audit services and the integrity of the issuer's financial statements without imposing an unnecessary burden on the RPAF or requiring the disclosure of information that is less likely to be of interest to investors or relevant to the Board's supervisory functions.

Proposed Item 2.6 of Form 3 – Criminal Proceedings Involving Individuals

Proposed Item 2.6 would require an RPAF to disclose if it had become aware that a partner, shareholder, principal, owner, member, or manager of the RPAF had become a defendant in a criminal proceeding and was charged with a wide range of enumerated crimes, including any crime arising out of alleged conduct relating to, among other things, "dishonesty," or with any crime arising out of alleged conduct that, if proven, would "bear materially on the individual's fitness to provide audit services to issuers."

We respectfully request that the Board eliminate the use of the term "dishonesty" in this proposed item. We believe that most business crimes, whether they are felonies or misdemeanors, involve at least some level of dishonesty, and Item 2.6 separately would require RPAFs to disclose criminal proceedings involving certain firm personnel that involved allegations of "fraud, embezzlement, forgery, extortion, bribery, obstruction of justice, perjury, or false statements," or which arose out of alleged conduct relating to "accounting, auditing, securities, banking, commodities, taxation, consumer protection [or] insurance." As a result, it is unclear exactly what the Board was attempting to capture with the inclusion of the additional term "dishonesty."

In addition, we request that the Board provide guidance with respect to what conduct would "bear materially on [an] individual's fitness to provide audit services to issuers." As noted, proposed Item 2.6 separately would require disclosure of a broad range of enumerated proceedings against certain firm personnel, including proceedings in which the alleged crime arose out of conduct related to accounting, auditing, or securities. Given the broad scope of this language, it is not clear what types of proceedings not already covered by other provisions of proposed Item 2.6 would "bear materially on [an] individual's fitness to provide audit services to issuers."

Proposed Item 2.7 of Form 3 – Civil or ADR Proceedings Involving the Firm

Proposed Item 2.7 would require an RPAF to file a special report if it had become aware that, in a matter arising out of the firm's conduct in the course of providing professional services for a client, the RPAF had become a defendant or respondent in a civil or ADR proceeding initiated by the government or in an administrative or disciplinary proceeding (other than a Board disciplinary proceeding).

Item 5.1.a of Form 1, an analogous provision in the Board's registration application, requires applicants to disclose pending civil or ADR proceedings initiated by the government arising out of the RPAF's "conduct in connection with an audit report, or a comparable report prepared for a client that is not an issuer." In comparison, proposed Item 2.7 of Form 3 is much broader in that it implicates matters arising out of a firm's provision of "professional services" to its clients. As a result, proposed Item 2.7 could require the special reporting of proceedings relating to consulting or other non-attest services that did not involve an RPAF's audit practice or the

integrity of any issuer's financial statements. Accordingly, in keeping with the standards set forth in the Board's registration requirements, we respectfully suggest that the Board limit the scope of proposed Item 2.7 to matters arising out of an RPAF's "conduct in connection with an audit report or a comparable report prepared for a non-issuer client."

Proposed Item 2.8 of Form 3 – Civil or ADR Proceedings Involving an Individual

Proposed Item 2.8 would require an RPAF to report if it had become aware that, in a matter arising out of the firm's conduct in the course of providing professional services for a client, a partner, shareholder, principal, owner, member, or manager of the RPAF became a defendant or respondent in a civil or ADR proceeding initiated by the government or in an administrative or disciplinary proceeding (other than a Board disciplinary proceeding).

Again, Item 5.1.a of Form 1 requires applicants to disclose pending civil or ADR proceedings initiated by the government arising out of conduct by associated persons of a firm "in connection with an audit report, or a comparable report prepared for a client that is not an issuer." In comparison, proposed Item 2.8 of Form 3 is much broader in that it implicates matters arising out of the provision by firm personnel of "professional services" to a firm's clients. As a result, proposed Item 2.8 could require the special reporting of proceedings relating to consulting or other non-attest services that did not involve an RPAF's audit practice or the integrity of any issuer's financial statements. Accordingly, in keeping with the standards set forth in the Board's registration requirements, we respectfully suggest that the Board limit the scope of proposed Item 2.8 to matters arising out of the conduct of associated persons of an RPAF "in connection with an audit report or a comparable report prepared for a non-issuer client."

Proposed Item 5.1 of Form 3 – Criminal, Governmental, Administrative, or Disciplinary Proceedings

In situations where an RPAF must file a special report on Form 3 pursuant to proposed Items 2.5 through 2.8, proposed Item 5.1 of Form 3 would require the RPAF to provide, among other things, a brief description of the RPAF's alleged violation of the statutes, rules, or legal duties at issue. In addition, an RPAF would be required to provide the name of every defendant or respondent who is a partner, shareholder, principal, owner, member, or manager of the RPAF and a brief description of each individual's alleged conduct in violation of the applicable statutes, rules, or legal duties.

In contrast, Item 5.1.b of Form 1, which contains an analogous requirement to disclose certain information regarding pending or concluded legal proceedings, requires a description of the statutes, rules, or other requirements the applicant or an associated person was alleged to have violated and, if applicable, the outcome of the proceeding. The disclosure requirements of Item 5.1.b of Form 1 provide the Board with the key information necessary to assess the legal or regulatory issues at issue in a pending or concluded proceeding, without burdening firms with an obligation to provide narrative descriptions of the alleged — and likely disputed — violations by

potentially numerous defendants or respondents in a single proceeding. We believe that the Board should follow an approach similar to that employed in Item 5.1.b of Form 1 in Item 5.1 of Form 3.

Proposed Item 2.13 of Form 3 – Certain Arrangements to Receive Consulting or Other Professional Services

Proposed Item 2.13 would require an RPAF to file a report on Form 3 if it entered into a "contractual or other arrangement to receive consulting or other professional services" from certain individuals who were currently the subject of either a Board disciplinary sanction suspending or barring the person from being an associated person of an RPAF, or a sanction under Rule 102(e) of the SEC's Rules of Practice suspending or denying the individual the privilege of appearing or practicing before the SEC. This proposed item also would require an RPAF to report if it had entered into a "contractual or other arrangement to receive consulting or other professional services" from entities subject to similar sanctions.

This proposed item would require RPAFs to collect information on and evaluate the current disciplinary status of all individuals and entities being considered to provide a wide range of consulting or other professional services to RPAFs. For example, RPAFs would be required to determine the disciplinary status of marketing consultants and other contractors who provide services far removed from a firm's audit-related functions. We submit that the Board should limit the scope of proposed Item 2.13 to apply only to those individuals and entities that enter into contractual or other arrangements with an RPAF to provide services in connection with the firm's audit reports for issuer audit clients. Given the limited nature and relevance of the relationship at issue, we believe that disclosure of disciplinary sanctions would be appropriate only if the consultant or contractor were engaged to provide services of this nature.

Proposed Item 2.15 of Form 3 – New License or Certification

Proposed Item 2.15 would require an RPAF to file a report on Form 3 if it had obtained a license or certification not identified on any Form 1 or Form 3 previously filed by the RPAF or if there had been a change in a license or certification number identified on a Form 1 or Form 3. We suggest that an RPAF should be allowed to report such information in an annual report on Form 2, rather than in a special report on Form 3. Specifically, it is not clear that such events would be of "some immediate concern" to the Board or have an immediate effect on the manner in which the Board carried out its regulatory responsibilities regarding the RPAF.[5] If there were a specific reason why the Board needed to know on an interim basis whether an RPAF had obtained any new licenses or certifications since the filing of its last Form 2, the Board could always request that information directly from the firm.

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[5] Proposing Release at 10.

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We appreciate the opportunity to comment on the Board's Proposed Rules. We are firmly committed to working with the PCAOB and would welcome the opportunity to meet with you to clarify any of our recommendations.

Sincerely,

Susan S. Coffey, CPA
Senior Vice President – Member Quality and State Regulation
AICPA

cc: Mr. Mark W. Olson, Chairman, PCAOB
Ms. Kayla J. Gillan, Member, PCAOB
Mr. Daniel L. Goelzer, Member, PCAOB
Mr. Willis D. Gradison, Member, PCAOB
Mr. Charles D. Niemeier, Member, PCAOB