Grant Thornton

Accountants and Business Advisors

September 14, 2007

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

Re: PCAOB Rulemaking Document 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 Board Members and Staff,

As a leading public accounting, tax, and business advisory firm, Grant Thornton LLP ("Grant Thornton") appreciates the opportunity to provide comments on key questions and issues affecting the criteria used to establish registered public accounting firms' independence. We welcome the opportunity to share our views on the Public Company Accounting Oversight Board's ("Board" or "PCAOB") Proposed Ethics and Independence Rule 3526 ("Proposed Rule 3526"), *Communication with Audit Committees Concerning Independence*, Proposed Amendment to Rule 3523 ("Proposed Rule 3523 Amendment"), *Tax Services for Persons in Financial Reporting Oversight Roles*, and the Board's related questions in PCAOB Release No. 2007-008.

Grant Thornton LLP is the U.S. member firm of Grant Thornton International, a global organization of member firms in over 100 countries. The views and comments expressed in this letter represent those of Grant Thornton LLP and do not constitute the views of Grant Thornton International or any of the other Grant Thornton International member firms.

Grant Thornton strongly supports the Board's commitment to strengthen the ethics and independence of registered public accounting firms that audit issuers' financial statements. Grant Thornton believes that robust ethics and independence standards are integral to investor confidence in the integrity of the audited financial statements.

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Proposed Rule 3526

Grant Thornton LLP is generally supportive of Proposed Rule 3526. Historically, Grant Thornton has supported the recommendations of the Blue Ribbon Commission and the independence rules and interpretations of the Independence Standards Board, and the U.S. Securities and Exchange Commission ("SEC" or the "Commission") independence rules (Section G of the January 2003 final rule, *Strengthening the Commission's Requirements Regarding Auditor Independence*), which encourage robust, periodic communication between an issuer's audit committee and the independent accounting firm. Proposed Rule 3526 would require documentation of the substance of discussions between an independent accounting firm and the issuer's audit committee. It would supersede *Independence Standards Board Standard No. 1, Independence Discussions with Audit Committees* ("ISB 1"), and ISB 1's two related interpretations.

Grant Thornton understands that Proposed Rule 3526 would require a registered public accounting firm ("registered firm") to provide the audit committee of a prospective or current issuer audit client (the "issuer audit committee") with the following:

- Written disclosures of relationships that may reasonably be thought to bear on the independence of the registered firm and its affiliated firms and discussions of the potential effects of these relationships on the registered firm's independence before the firm's acceptance of an initial engagement
- Similar written communications on an annual basis thereafter, including an independence affirmation that the registered firm is independent pursuant to PCAOB Rule 3520

We believe that the written communications and discussions between the registered firm that is the auditor of record and the issuer audit committee emphasizes the importance of independence, in fact and in appearance, as a critical component of audit quality. The discussions provide an opportunity to augment the identified independence threats and safeguards that may reasonably be thought to bear on the registered firm's independence. However, we would request that the Board consider our comments on the following topics before final approval of Proposed Rule 3526:

- Consistency of Proposed Rule 3526 with existing SEC independence rules
- Definition of "affiliates of the firm"
- Recognition of legal impediments to Rule 3523 disclosures
- Audit period pertaining to initial and subsequent written communications
- Additional guidance for issuers without audit committees
- Multiple issuers with the same audit committee, such as entities within the same investment company complex

Consistency with the SEC's January 2003 final independence rule

As required by the Sarbanes Oxley Act of 2002 (the "Act"), Section G of the SEC's January 2003 final independence rules includes detailed requirements on auditor communications with audit committees, including an independence requirement. We believe that the Board's independence communications requirement should be consistent with Section G since it represents the SEC's codification of the Act.

Specifically, we believe that the guidance in Section G pertaining to investment companies and entities within the same investment company complex with respect to the timing of required communications, including the independence letter, modernizes the requirements imposed by ISB 1 and its related interpretations. Further, for initial registrations by an entity within the same investment company complex or control group, we believe that the Section G requirements for communications with the investment company complex's audit committee—that is, 90 days before the initial filing—should be sufficient to comply with Proposed Rule3526.

Definition of affiliates of the firm

Proposed Rule 3526 requires communication of all relationships between the "registered public accounting firm or any affiliates of the firm." In its interim or final rules, the Board has not defined "affiliates of the firm." Grant Thornton encourages the Board to adopt a definition consistent with the SEC's term "associated entities" (FRR 602.01.H.2). Alternatively, we request that the Board either specifically define the term through reference to PCAOB standards or rules or, similar to the European Union, adopt criteria for identifying network firms.

Potential legal impediments for disclosure of personal income tax information

The Internal Revenue Code and state tax provisions specifically prohibit disclosure of personal income tax information by tax preparers without the specific consent of the clients. Furthermore, many foreign jurisdictions exercise more stringent legal prohibitions on disclosure of personal information due to strict data privacy laws and regulations. However, if a Grant Thornton International member firm has a legal impediment to providing requested information to Grant Thornton LLP, we may not be able to provide full disclosure to a prospective issuer client's audit committee. Additionally, we anticipate that all non-US registered accounting firms will have to obtain a legal opinion on their ability to make such disclosures when the firms subsequently update their PCAOB registration.

Due to the significant preparer penalties imposed on violations of taxpayer confidential information or privacy statutes, we believe that the Board needs to specifically address these legal impediments before adoption of this requirement. Therefore, we ask the Board to consult with its own legal and international counsel on how best to structure the requirement to disclose confidential information related to income tax services provided to an individual in a financial reporting oversight role (FROR) or the individual's family members.

Audit period in the initial written communications and in the annual updates

Grant Thornton recommends that the initial written communication include only the audit period(s) in which independence will be required if the prospective auditing firm is named as the issuer's auditor of record. The successor auditor is required to be independent of the audit periods for which the auditor renders its reports, through the period of the engagement, and, in subsequent periods when the auditor-client relationship has ceased, the period of the updates to the auditor's report. The predecessor auditor must be independent at the date(s) of its reports and the registrant will ask the predecessor auditor to consent to the inclusion of its report or reports in the filing. The successor auditor does not take responsibility for any of the registrant's fiscal years or periods unless the successor subsequently audits that period.

In normal circumstances, the successor auditor and the audit committee need not be concerned about the successor auditor's independence in prior periods. In the event of a restatement or a reaudit, the successor auditor will undertake a thorough independence analysis of the prior period(s) to assess whether the successor could audit the period(s). Therefore, we believe that there may be little benefit gained from requiring the auditing firm to disclose all independence matters affecting any year that independence is not required.

Further, the checks for independence conflicts require substantial effort by both company management and the auditing firm. Due to the complexity of the SEC's definition of an "affiliate of the audit client" (Rule 2-01(f)(4)), an independence analysis of all affiliates would be a time-consuming process. For example, if a portfolio company of a large private equity group is an issuer due to publicly traded debt securities, the registered firm must undertake an analysis not only of the portfolio company and its direct affiliates, but also of the other portfolio companies and their affiliates controlled by the same private equity group. This would trigger multiple layers of inquiry and analyses that would result in disclosure that has no bearing on the audit committee's requirements under The Act or Section D of the SEC's January 2003 independence rules.

Fundamentally, we believe that the underlying principle in Proposed Rule 3526 should be enhancement of the communications and dialogue between the prospective or current auditor of record and the audit committee. As a result, we recommend that the written communications and discussions address independence threats and related safeguards that either arise during the audit period or, if the matters arose in prior periods, are of continuing importance to the audit committee. In other words, all independence concerns that may reasonably be thought to bear on the auditor's independence in the current period should be addressed.

Grant Thornton understands that the independent directors on an audit committee may periodically change. However, we believe that before agreeing to become an independent director and serving on the audit committee, the prospective audit committee member should undertake its own due diligence by reading the audit committee charter, the disclosures in the proxy statements or other filings pertaining to auditor independence, the committee's minutes, and previously issued written communications by the auditor of record. As clearly delineated in the Act, the audit committee members have certain responsibilities related to maintaining the auditor's independence. Therefore, we categorically reject that the auditor of record has a responsibility to perform the due diligence for a prospective audit committee member or an audit committee member who forgoes its duties.

While an audit committee or the auditor of record may elect to include prior periods or independence matters that no longer pertain to the current audit, Grant Thornton does not support inclusion of matters that are no longer pertinent to the audit committee's assessment of the registered firm's independence. Therefore, we believe that limiting the relevant audit period or periods to those in which the auditor is engaged in providing services, as well as limiting independence matters to issues that fall under PCAOB standards, best achieves Proposed Rule 3526's underlying principle.

Issuers without audit committees

We also encourage the Board to provide guidance for situations in which an issuer audit client does not have an audit committee. Under the ISB 1 standards, the independence disclosures would default to the issuer audit client's governing board or body. We believe that many entities initiating an initial public offering may not have an audit committee or an independent board member who could serve on the audit committee when it initially files with the Commission. Further, other entities also may lack audit committees, such as certain employee benefit plans that file on Form 11-K, certain foreign private issuers, limited partnerships with publicly traded units, or unit investment trusts.

Additionally, the SEC rules requires a registered firm to apply the PCAOB standards if it is a secondary auditor or if its auditor's report for a nonissuer is included in an issuer's filing with the Commission. For example, the SEC requires application of PCAOB standards for the audit of a nonpublic entity that is a significant investee of a registrant and for reports on an asset-backed securities servicer or subservicer. Frequently, a secondary firm may be a non-US accounting firm auditing certain international operations and, depending on whether the firm "plays a substantial role" in the audit, it may or may not render an auditor's report in filing with the Commission. In these cases, the principal or primary auditor frequently asks the secondary auditor for independence affirmations and for information for its ISB 1 communications to the issuer, but the secondary auditor may not have the opportunity to review the primary auditor's ISB 1 communication or to be a party to the independence discussions with the issuer's audit committees. Because we believe that these communications are largely beyond the secondary auditor's control, we request consideration of an exemption for secondary auditors from Proposed Rule 3526's requirements for communication with the issuer's audit committee.

Multiple issuers with the same audit committee

Many mutual funds, unit investment trusts, limited partnerships, or other similar entities that are in the same investment company complex may not have separate audit committees or governing boards. Frequently, the registered firm's engagement includes the audit of the initial deposit or a start-up mutual fund. For these types of entities, written communications to the audit committee or its equivalent have conformed to the requirements of Section G of the SEC's January 2003 final independence rules. We believe that initial communications within the 90 day period permitted by Section G for an investment company complex substantially meets the spirit and intent of Proposed Rule 3526's requirement for written communications and discussions to occur before the period of the engagement begins.

PCAOB questions and Grant Thornton comments

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

   The requirement to have a registered firm disclose and discuss independence matters that may reasonably be thought to bear on the auditor's independence will assist an issuer audit committee fulfill its responsibilities before engaging a new auditor. However, we believe that Proposed Rule 3526 largely codifies existing practice for registered firms. As a practical matter, before a registered firm agrees to be appointed as the auditor of record, it generally analyzes all identified relationships in the current audit period and in prior audit periods that are thought to have a bearing on the firm and its affiliated firms' independence.

   In our experience, an issuer audit committee generally requires issuer management to undertake similar due diligence. Further, consistent with the requirements of Section 202 of the Sarbanes-Oxley Act and Section D of the SEC's January 2003 final independence rules, an issuer audit committee invariably evaluates a prospective auditor's independence as one of its primary qualifications. Neither the newly appointed registered firm nor an issuer audit committee wants to negatively affect investor confidence with the resignation of a newly appointed auditor due to independence issues that were not fully vetted before the change was announced.

   Because Proposed Rule 3526 corresponds closely to ISB 1 and its interpretations' requirements to update an auditor's identification of independence threats and safeguards and the auditor's conclusions thereon at least annually, we believe that the proposed rule does not create any substantive changes in current practice for registered firms or issuer audit committees.

2. **Would proposed Rule 3526 assist audit committees in making a decision regarding the appointment of a new auditor?**
   As discussed above, audit committees adhere to Section D of the SEC's January 2003 final independence rules, the audit committee charter, and/or exchange guidelines in the performance of their duties. In our experience, an issuer audit committee generally requests that both company management and all of the proposing registered firms conduct thorough, global independence fact gathering and analysis before a new auditor is appointed. Registered firms and issuer audit committees currently discuss and resolve any identified independence matters before the new auditor's appointment. Therefore, we do not believe that Proposed Rule 3526 will greatly enhance current practice.

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?**
   In addition to matters that may reasonably be thought to bear on independence, Proposed Rule 3526 would require the registered firm to disclose whether it or any associated firm had performed tax services, prior to the beginning of the audit period, for an FROR or the FROR's immediate family member. As previously discussed, Grant Thornton requests that the PCAOB consider the numerous legal impediments that exist in the US and internationally that could impact a registered firm's ability to meet this requirement. We ask that the Board consult its US and international tax counsel before finalizing this requirement.

4. **To what extent, if any, are accounting firms already making the kinds of communications that would be required by proposed Rule 3526?**
   We believe that registered firms already comply with the disclosure requirements of Section G of the Commission's January 2003 final independence rule, including the independence letter specified in section 3. We also believe that these communications, except for the disclosure of tax services to an FROR or its immediate family members, between the prospective auditors and the audit committee represent common practice.

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?**
   As discussed above, the initial communication should be limited to the relationships that existed during the prospective client's audit period or periods in which the auditor initially renders its report. For example, for an existing registrant, Grant Thornton believes that the period of interest to the audit committee is the period in which the registered firm is engaged to perform the audit or audits under PCAOB standards, which is generally the current fiscal period. For an entity undergoing initial registration with the Commission, the auditor would include all periods included in the auditor's report in the auditor's initial communication to the audit committee or its equivalent.

However, if independence threats are ongoing, such as permitted services or relationships, then the auditor should continue to include these matters in written communications and in discussions until the auditor concludes that these matters are no longer pertinent. The auditor needs to provide sufficient information for the audit committee to make its own assessment of auditor independence.

At some point, the effort required to develop the information about relationships in the past and to discuss that information with the audit committee outweighs the value of such information to the audit committee. A clear limitation on the scope of both diligence that the firm must perform and matters that the audit committee must consider will make the process more efficient. It will also help accountants and audit committees to focus on relationships that are most likely to be relevant in ascertaining whether the accounting firm is independent for purposes of the current audit.

Proposed Rule 3523 Amendment

Grant Thornton strongly supports the Proposed Rule 3523 Amendment. As we discussed in our May 17, 2007 comment letter on the questions posed in PCAOB Release No. 2007-002, Grant Thornton strongly supports eliminating the prohibition against providing tax services to an FROR or its immediate family members in the client's fiscal period before the engagement begins. We believe that the elimination of this prohibition will greatly enhance an audit committee's ability to select a new independent auditor.

If the tax services to the FROR or its immediate family members are completed or terminated before the professional engagement period begins, we believe that there is no ongoing mutuality of interest or continuing association. For a US FROR, we believe that a mutuality of interest may possibly exist if tax positions recommended by the registered firm do not meet either the PCAOB's or US Internal Revenue Service's "more likely than not" criteria. In evaluating its independence with respect to the issuer, its officers, directors, and substantial shareholders, the registered firm now generally assesses the tax consulting and compliance services provided to an FROR or its immediate family members to evaluate whether an ongoing mutuality of interest exists.

Grant Thornton also strongly endorses the Board's stated intention to provide a footnote to explain the application of Rule 3523 in the context of an initial public offering ("IPO"). We concur with the Board's conclusion that Rule 3523 should not apply before the earlier of when the registered firm signs an initial engagement letter to perform an audit pursuant to PCAOB standards or begins audit or interim review procedures.

We would request that the Board consider other circumstances in which an entity becomes an issuer. For example, a registration may arise from the

- Issuance of publicly traded debt
- Issuance of partnership or other units
- Reverse merger in which a nonpublic entity succeeds to the public registration
- Inclusion of a public sponsor's securities in an employee benefit plan and a determination by SEC counsel that a Form 11-K filing is required
- Decision by a foreign private issuer to file with the Commission
- Exceeding 500 shareholders coupled with the entity's total assets exceeding $10 million as of the latest fiscal year end

PCAOB questions and Grant Thornton comments

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?**

   The Board has solicited additional comment on the practical implications of not providing a transition period for a registered firm to complete tax services after the professional engagement period begins. We believe that an initial transition period should be permitted to ensure consistency with Rule 3523's current 180-day transition period. Since a transition period is permitted if an individual becomes an FROR or if a corporate event occurs, we do not see any substantial difference between these situations and the appearance of a mutuality of interest when a registered firm is initially engaged as the auditor of record.

   The FROR bears the most significant hardship for terminating tax services since it must find another tax return preparer to meet its filing deadlines. The registered firm providing the service to the FROR may suffer damage to its reputation if it terminates the FROR's tax services because it believes the FROR may have difficulty meeting filing deadlines. We believe that requiring a registered firm to terminate services when such termination may cause potential harm or jeopardy to a tax client generally runs counter to the accountant's professional ethics and value systems.

Further, the audit committee (assuming there are no legal impediments to the Proposed Rule 3526 disclosure) is placed in an equally untenable position. The issuer audit committee may need to select a registered firm that is not its first choice or engage a firm that will have to resign from any tax services engagement with an FROR before the engagement period begins. If there is no ongoing mutuality of interest created by providing the tax services and such services are terminated within 180 days of the start of the engagement, we believe that the audit committee should be able to exercise its responsibilities under the Act and Section D of the January 2003 independence rules without additional constraints.

In addition, Rule 3523 requires that the registered firm terminate or conclude tax services to any FROR or its immediate family members at any of the issuer's material subsidiaries. The determination of whether a subsidiary is a material affiliate is in itself an audit procedure. Additionally, due to changes in operations, business strategy, or growth, different subsidiaries may become more significant during a given audit period. Also, certain locations may be subject to audit procedures due to periodic rotation of various locations for the integrated audit procedures. If an entity became a significant subsidiary or is subject to audit procedures during the audit period, the issuer and the auditor need sufficient time to terminate previously permitted tax services to an FROR or its immediate family members at that entity.

The ability of a US registered firm and a non-US registered firm to terminate or extend the deadline for a tax filing may differ greatly. While a US-registered firm may terminate its tax services engagement or obtain an extension for filing tax returns, non-US firms may face significant legal impediments in terminating services or obtaining extensions of filing due dates. We believe that a 180-day transition period would alleviate many of the legal impediments and other issues faced by non-US firms in complying with Rule 3523.

Finally, Grant Thornton does not see any theoretical difference between the permitted 180-day transition period permitted for a new FROR or another corporate event and the change in auditors. If no mutuality of interest is assumed for the permitted transition period, then no mutuality of interest should be presumed for the finalization of tax services from the date that the period of the engagement commences.

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We would be pleased to discuss our comments with you. If you have any questions, please contact Karin French, Assistant National Managing Partner of Professional Standards, at 703-847-7533.

Very truly yours,

Grant Thornton LLP

Grant Thornton LLP