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February 14, 2005

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW, 9th Floor
Washington, DC 20006

Re: PCAOB Rulemaking Docket Matter No. 017, Proposed Ethics and Independence Rules Concerning Independence, Tax Services and Contingent Fees.

Dear Mr. Secretary,

PricewaterhouseCoopers[1] is pleased to submit our comments on the Board's proposed rulemaking with respect to independence, tax services and contingent fees. We are fully supportive of the Board's decision to engage in rulemaking with respect to these important topics. We have reviewed the proposed rules and have a number of observations and proposals that we believe will help support the overall objectives of the Board. We agree with the Board that auditor independence is a cornerstone of investor confidence in the accounting profession's role with respect to financial reporting. We also agree that a clear understanding of the rules and properly applied sanctions surrounding auditor independence are a necessary part of this process.

We are pleased that the Board has recognized that an auditor's healthy and robust tax practice is integral to enhanced audit quality – by definition, audits of financial statements require often complicated analyses of tax related issues and audit firms must develop and retain the resources and expertise to be able to properly address these issues. We also agree that the provision of certain tax services by an auditor to its audit clients, such as routine tax planning and compliance work, also contributes to enhanced audit quality and, equally important, is not likely to impair an auditor's independence. The Board's detailed commentary on acceptable auditor provided tax services provides clarity to audit committees considering whether to engage their auditors for those services.

We agree with the Board's decision to restrict auditor provided tax services with respect to aggressive tax positions and the provision of tax services to officers in a financial reporting oversight role. We believe that greater clarity around definitions and implementation matters with respect to these rules will provide the guidance required by

[1] "PricewaterhouseCoopers" refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity. PricewaterhouseCoopers LLP refers to the member firm conducting business in the United States.

issuers and auditors alike. Accordingly, our comments are directed toward those matters and their possible resolution.

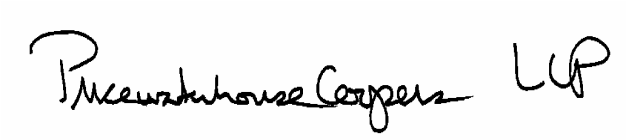
A number of our comments, particularly in connection with the rule relating to aggressive tax positions, are of a technical nature and are designed to assist the Board in clarifying the application of the rules.

We believe, however, that the Board's proposal with respect to audit committee pre-approval may increase the administrative burden on audit committees. Accordingly, we urge the Board to consider the impact its prescriptive approach has on the ability of audit committees to determine the form and content of their pre-approval policies, particularly in light of the fact that the pre-approval requirements are relatively new and should be given a chance to work.

Finally, with respect to the Board's proposed rule surrounding an associated person's responsibilities not to cause violations, we believe that the Board should fully consider the potential consequences of the proposed standard and in light of those potential consequences, as well as the Board's ability to achieve its objectives through the inspection process, whether negligence is the appropriate standard for secondary liability of associated persons.

Should you have questions regarding our comments or require any other information, please contact Richard Kilgust at 646-471-6110, Samuel Burke at 201-521-4460 or Carl Duyck at 202-414-4402.

Very truly yours,



PricewaterhouseCoopers

PROPOSED ETHICS AND INDEPENDENCE RULES CONCERNING INDEPENDENCE, TAX SERVICES, AND CONTINGENT FEES

PCAOB Release No. 2004-015, December 14, 2004; PCAOB Rulemaking Docket No. 017

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I. THE AUDITOR'S INVOLVEMENT WITH THE AUDIT COMMITTEE – Proposed Rule 3524

A. The Board Should Take Additional Time to Consider the Pre-Approval Requirements that Go Beyond the Statutory Mandate.

Proposed Rule 3524 would require an audit firm to provide to audit committees engagement letters or other agreements relating to each proposed tax service and would further require that the accounting firm discuss with the audit committee the potential effects of each service on the firm's independence. We support the Board's goal of ensuring that audit committees are in a position to make reasoned and informed judgments on an auditor's independence. We also agree with the Board's statements that the rule should eschew any rigid, mechanical approach and that audit committees should be given wide discretion to make these determinations. Finally, we agree with the Board's conclusion that a viable tax practice within audit firms is important to the retention of highly qualified individuals who, in addition to providing tax services, are integral to supporting the audit process.

Audit committees are taking the pre-approval requirements seriously. The Board has the opportunity through its inspection process to review how the process is operating for itself. In light of the additional burdens that the rule will place on audit committees and in the absence of an identified systemic problem, we would suggest that the proposed requirements should be deferred and only introduced to the extent that systemic issues which need to be dealt with are identified.

However, if the Board decides to move forward with this rule now, we believe that the proposed rule should be modified to afford audit committees greater flexibility to determine the specific nature of the documentation and discussions required for the individual service under consideration.

1. The Potential Effect of the Additional Pre-Approval Requirements on Audit Quality is Unclear.

Since enactment of the Securities and Exchange Commission's rules implementing the pre-approval requirements of the Sarbanes-Oxley Act, it has been apparent that audit committees are taking the pre-approval requirement seriously and that the statutory intent behind the requirement is being met under the current rules. Therefore, while we welcome additional guidance from the Board to ensure that audit committees are fully informed of the nature of the tax services to be provided by the auditor, we believe that care should be taken to ensure that any such additional requirements achieve the desired results.[1]

[1] In the proposing release, the Board states that, "…the Board's rules do not yet include general auditor requirements relating to the Act's and SEC's new pre-approval requirements." This statement is footnoted (No. 29) with a reference to the pre-approval requirements included in Auditing Standard No. 2 which are described as requiring specific pre-approval by the audit committee for each engagement. The release goes

Audit committees directly oversee the auditor relationship including understanding the services that are being provided by the auditor. Where an auditor provides tax services that are subject to audit committee oversight, the audit committee is likely to have a better understanding of the financial statement impact of tax matters affecting the company than it might if another provider is providing the service. From a policy perspective, as with the effect of tax services on audit quality, the audit committee's continued involvement in the tax process is in the interest of investors.

Requiring that specific documents or materials such as engagement letters be provided to the audit committee will impact the behaviour of those subject to the requirement. It is unclear what effect these specific documentation requirements will have on audit committee effectiveness and it may have the unintended consequence of impacting the provision of tax services more broadly. Notwithstanding the Board's desire to permit auditors to provide tax services in order to enhance the quality of audits, in some situations audit committees may choose to engage another service provider simply to avoid the administrative burden that would result from a requirement to review each engagement letter. This may cause an unintended reduction in transparency in this area.

The Board has at its disposal a number of tools that can be used to ensure that auditors are providing audit committees with sufficient information related to tax engagements. For example, through its inspection process, which often includes interviews with audit committee members, and the documentation of discussions with the audit committee, the Board is able to evaluate the nature of discussions that have taken place. In the event that the Board identifies systemic issues of concern, the Board should undertake remedial measures in those situations where concerns exist. We believe that – for now – the Board should defer the proposed requirements due to the likelihood of increased burdens on audit committees and the potential for unintended consequences.

2. The Mandatory Requirement to Provide Engagement Letters and Other Documentation May Not be Consistent with Congressional and Commission Intent to Provide Flexibility to Audit Committees.

As the Board has stated, the pre-approval process should be flexible enough to encourage audit committees to develop systems tailored to the needs and attributes of the issuer. This supports the need for a clear and effective, but also flexible, rule which focuses on the nature of services provided, the manner in which fees for services are determined, and the impact those services may have on auditor independence. Such a rule should set a rational basis by which audit committees can most effectively and efficiently distinguish between those services requiring greater attention and those of a

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on to say that "[T]he proposed rule would implement these requirements…" We believe that the Board should clarify the potential inconsistency.

more routine nature.[2] We agree, without question, that audit committees should fully understand the nature and scope of the services that are to be provided by the auditor, based on the needs and expectations of each audit committee and issuer.

In devising the pre-approval requirement, Congress recognized that audit committees possess varying levels of expertise and experience and, consequently, did not prescribe specific procedures applicable to the pre-approval process. During its rulemaking process, the Commission specifically considered whether fewer aspects of the pre-approval process should be left to the discretion of an audit committee and whether the Commission should mandate specific matters to be communicated to or considered by an audit committee. Consistent with Congress' intent, the Commission concluded that a prescriptive approach would not enhance the pre-approval regime and that a high level of audit committee discretion was appropriate to account for the particular circumstances of the issuer and its relationship with its auditor (*see also, Application of the January 2003 Rules on Auditor Independence FAQs, Audit Committee Pre-Approval*, Answer No. 24, August 13, 2003, where the SEC Staff noted that "if a cover sheet describing the non-audit service is provided to the audit committee it must include documentation that fully describes the proposed services being offered").

3. The Proposed Rule Should Not Specify Particular Documents for Audit Committee Review and Should be Modified to Focus on the Specific Nature of Individual Non-Audit Services.

We are concerned that the proposed requirement to provide engagement letters and other materials for each individual service, without allowing audit committees to consider their own individual needs, would place a significant burden on audit committees. Audit firms may issue numerous engagement letters to a client, making it impractical for audit committees to review each agreement while still focusing on the substantive issues relating to auditor independence. We recognize that in some circumstances, audit committees may feel it appropriate to review all engagement letters for tax services and we fully support that option. All of an audit firm's engagement letters with an audit client are as a matter of course available to audit committees for review upon request. However, to impose the requirement on all audit committees, allowing for no individual determination, is an inflexible and burdensome solution to a problem that has not been demonstrated to exist.

Large multinational corporations, for example, may issue engagement letters with great frequency in dozens of jurisdictions. These multinational corporations are composed of a multitude of entities which engage in transactions and operations requiring the provision of a broad range of permissible routine tax services and more complex tax advice. These services vary substantially both in scale and frequency, depending on the particular business need. We believe that in certain instances the number of individual tax engagements and resulting engagement letters could exceed 100 engagements per

[2] Indeed, the U.S. capital markets are built on a free enterprise system that allows companies flexibility to design their operations to achieve their business goals. Care should be taken not to regulate the process that audit committees must undertake prior to making decisions that fall under their fiduciary mandate.

year. This may include many engagement letters that cover multiple individual engagements on a recurring basis, over a long period, and in different languages that cover many legal systems (*e.g.*, compliance tax services are generally provided under separate individual contracts because of the country specific legal, risk management and service requirements). These services vary substantially both in scale and frequency, depending on the particular business need.

The burden on the audit committee resulting from the amount of paperwork generated by all of these engagements in the aggregate may well outweigh any benefit provided by the review – such determination should be left to the audit committee. Mandating such a process, without allowing audit committee discretion, may not, in an audit committee's judgment, contribute to its assessment regarding independence.

Further, a significant amount of tax compliance and planning advice is of a recurring nature or involves engagements that are substantially similar to engagements that have been previously pre-approved. Therefore, such services may be understood by the audit committee without review of individual documents specific to each engagement. Indeed it is possible that an engagement letter will cover multiple engagements of a similar kind (*e.g.*, routine tax advisory or planning services) over a prolonged period, without necessarily providing further detail on the specific services which are ultimately delivered subject to the terms of that engagement letter. Our proposal allows audit committees the flexibility to determine a process for pre-approval based on the relevant facts and circumstances for each issuer.[3]

As stated in the commentary to the Rule the purpose of the Rule is to provide audit committees with a "robust foundation of information upon which to determine whether to pre-approve proposed tax services" (*Rulemaking Release* at Page 40). We fully support achieving that objective so that audit committees can independently evaluate non-audit service offerings and their impact on independence. Implicit in any service offering that an audit firm takes to an audit committee for pre-approval is the audit firm's conclusion that the service does not impair independence. We support the requirement that the auditor should discuss with the audit committee the independence implications of services and provide support for its analysis during the discussion with the audit committee. We do not believe, however, that such analysis should be the sole basis on which the audit committee makes its determinations. We are concerned that the proposed requirements could result in audit committees relying on the analysis provided by their auditors as the key determining factor in its evaluations of the independence implications of tax service offerings. The audit committee's conclusion regarding independence is equally important. We believe that the nature of the discussions with the

[3] Audit committees must fully understand the services that are to be provided by the auditor. It is also important to recognize that the role of the audit committee does not, in practice, stop with the initial approval. Rather periodic discussions and updates (*i.e.*, during quarterly audit committee meetings) are becoming increasingly customary and are valuable in making sure that audit committees are informed of the status of engagements and have access to subject matter experts.

audit firm and the audit committee's own conclusions, which are reflected in the audit committee's minutes are essential elements of the pre-approval process.

Proposal:

- The Board should assess the efficacy of the pre-approval process in the future and adopt changes to the process as needs dictate.

- Audit committees should have the flexibility to pre-approve routine and recurring services at their regularly scheduled meetings, or on an annual basis, after fully understanding the services that are to be provided and discussing with their auditor any independence implications.

- Audit committees should have the flexibility to pre-approve any other permissible services not envisioned or discussed at the scheduled meetings after fully understanding the services that are to be provided and discussing with their auditor any independence implications.

- Audit committees should in all circumstances have the discretion to determine the nature of the documents and discussions required for a fully-informed, well-reasoned decision on whether to pre-approve a tax service.

B. The Proposed Rule Should be Clarified to Indicate that it Applies Only to Services Pre-Approved On or After the Effective Date of the Rule.

The rulemaking release proposes an effective date for the rules of October 20, 2005, or 10 days after Commission approval of the rules. As a result, non-audit services already pre-approved under existing rules but not completed until after the effective date would become subject to a new pre-approval regime. We believe that potential retroactive application of the rule to those services already pre-approved under existing requirements would lead to administrative difficulties and additional costs.

Proposal:

- We recommend that the proposed rule be clarified to apply only to pre-approval of services entered into on or after the effective date and that services pre-approved prior to the effective date may continue to be provided without being subject to the new requirements.

C. For the Sake of Clarity, the Board Should Adopt the Commission's Definition of those Entities that are Subject to Pre-Approval.

The proposed rule defines the term "audit client" to include any affiliates of the audit client and, therefore, in connection with the auditor seeking audit committee pre-approval to perform for an audit client any permissible tax service, the term audit client includes, by definition, the audit client's affiliates. In 2003, the Commission considered

carefully those entities whose engagements would be subject to pre-approval by the issuer's audit committee. We believe this included an evaluation of the legal limitations that may exist for some audit clients in relation to their affiliates. In response to the comments raised, the Commission concluded that pre-approval was required by only those entities who were issuers (as defined in the Sarbanes-Oxley Act) and their consolidated subsidiaries as opposed to each of the affiliates that are subject to the independence rules by virtue of the application of the definitions included in Rule 2-01 of Regulation S-X. In addition, the Commission's pre-approval requirements for those entities in an investment company complex recognized the complexities and relationships specific to investment companies.

Proposal:

- We recommend that the Board make clear that, to the extent that the Board's pre-approval requirements differ from the Commission's requirements, the entities subject to pre-approval are the same as those which are subject to the Commission's rules. Specifically, we recommend that the term "audit client" be removed from pre-approval requirement and replaced with definitions that are the same as those contained in Rule 2-01(c)(7) of Regulation S-X.

II. TAX TRANSACTIONS – Proposed Rule 3522

A. The Board Should Adopt Proposed Rule 3522 with Limited Technical Modification to Ensure Clarity, Enhance Audit Quality and Facilitate Appropriate Extra-Territorial Application.

We agree with the Board's conclusion that there is a need for rules to limit an auditor's involvement in tax shelters and aggressive tax positions and support the Board's proposal. We believe neither an audit firm nor its affiliates should bring a tax shelter or other aggressive tax position transaction to an audit client and should not assist an audit client's undertaking of such transactions or their implementation.

We provide comments and observations to the Board below, a number of them technical points relating to the provision of tax services, to help the Board achieve the objectives of this rule as well as formulate the rule in a way to maximize audit quality. Due to the nature of certain tax transactions and the fact that their official status can change over time, we have suggested certain clarifications that would allow an audit firm to exit an engagement that had been permitted at inception, but due to unanticipated factors outside of the audit firm's control, changed the status of the engagement for ongoing services. Our comments also seek to achieve clarity in the rule, which is of particular importance to audit committees, audit clients and audit firms.

We strongly believe that audit quality and overall transparency is enhanced if the audit firm is able to advise the client and the client's audit committee that the client is undertaking a transaction the auditor views as a tax shelter or other aggressive tax position transaction, the basis for this view, and the tax and financial statement consequences of such an undertaking. Permitting the auditor to function in this way serves the public interest because the auditor would have a better understanding of the transaction and the appropriateness of its treatment in the audit client's financial statements.

We believe that the three-pronged test articulated in Proposed Rule 3522(c), with modifications described in more detail below, adequately defines aggressive tax transactions. In view of the public interest served by allowing the audit firm to advise audit clients and their audit committees on aggressive tax positions, the Board should clarify the definitions and standards set forth in Proposed Rule 3522(c) to further the Board's dual goals of ensuring auditor independence while continuing to permit auditor-provided tax services, both of which contribute to enhanced audit quality.

Below we first provide comments and observations that generally apply to the rule as proposed and then provide suggestions relating to each type of transaction enumerated in the proposed rule. Our comments assume that any non-audit service provided to an audit client is pre-approved by the audit committee.

B. Certain Proposed Clarifications Apply to All Aspects of the Rule.

The following are comments that we believe have general application to each of the three types of transaction covered by Proposed Rule 3522 (*i.e.*, listed and confidential transactions as well as aggressive tax positions).

1. The Board should clarify that audit firms need to be able to advise on transactions not promoted by them in order to enhance audit quality.

Proposed Rule 3522 provides that an auditor is not independent of its audit client if it provides non-audit services to the client "related to planning or opining on the tax treatment" of three enumerated types of transactions. We believe that auditor independence generally would not be called into question when an audit firm advises its client on matters pertaining to a transaction that the audit firm had no role, directly or indirectly, in bringing to the client's attention. To the contrary, allowing an audit firm to advise the client on such transactions permits it to obtain a better understanding of the relevant facts and legal principles related to the transaction, thereby enhancing the quality of the overall audit.

Tax planning is a dynamic process that may involve a variety of stages. A client may consult with its advisors to engage in brainstorming sessions to discuss specific goals with respect to future transactions generally or with respect to transactions currently contemplated or in progress. During these sessions (which can span many months), the strengths and weaknesses of various options for structuring a proposed transaction are analyzed in depth. Similarly, a client may engage in the planning process with a single advisor. At some point in the planning process, the structure of the transaction becomes more concrete and the client decides the tax position that it prefers to pursue.

The auditor is required to consider the impact of such transactions in performing the audit and plan its work accordingly. In that light, the audit client, before it enters into a potential transaction, frequently asks the auditor to review the potential transaction in advance and determine whether it would achieve their objectives. This practice should be encouraged, as it will contribute to a higher quality audit and it naturally follows that any comments made by the auditor will be in the nature of tax planning and compliance advice and should be permitted.

Proposed Rule 3522 does not permit such advice in the case of any listed or confidential transaction (as those terms are defined in Proposed Rule 3522(a) and (b)) or, in the case of an aggressive tax position as defined in Proposed Rule 3522(c), unless the transaction was not initially recommended by any outside advisor. We believe that the Board should clarify the scope of this prohibition so that auditors can properly advise their clients.

We further suggest certain safeguards to accompany these proposed modifications. First, audit firms should not be able to provide the prohibited services to

audit clients indirectly through an alliance with a promoter or other alliance partner. We propose, therefore that the words "directly or indirectly" and a description of what "indirectly" encompasses be added to the rule in order to prohibit this behavior. Second, the Board should (i) require that audit firms advise the audit committee when the audit firm becomes aware that a client decided to undertake a tax shelter or an aggressive tax position and (ii) clarify which services can be rendered by the auditor with regard to the transaction.

Proposals:

- An auditor should not be permitted to bring, directly or indirectly, to an audit client a tax shelter or other aggressive tax position transaction described in Proposed Rule 3522.

- Indirect activities should encompass situations in which an affiliate of the audit firm or other advisor, with which the audit firm has a business relationship relating to the promotion of such transaction, brings the transaction to the audit client.

- An auditor should be permitted to advise on the tax aspects of a transaction, if the audit firm did not, directly or indirectly, bring the transaction to the client (including a transaction proposed by the audit firm that is executed in a different form). Should the audit client decide to pursue a tax shelter or aggressive tax position transaction described in Proposed Rule 3522, the primary role of the audit firm thereafter should be to advise the client and the client's audit committee that the client is undertaking a transaction the auditor views as a tax shelter or other aggressive tax position transaction, the basis for this view, and the tax and financial statement consequences of such an undertaking. The audit firm should prepare contemporaneous documentation of its conclusion and cessation of further advice regarding the implementation of the transaction. In addition, the audit firm should be permitted to advise on tax law disclosure associated with the transaction and penalties for not complying with the disclosure requirements, to prepare tax returns impacted by such transaction provided that the transaction is properly disclosed on any such return, and to represent the client in connection with the examination of any such tax returns (such representation would cease when the audit client files a petition, claim, or similar legal filing to commence a court proceeding with respect to the issue). Any advice provided before the audit client decides to pursue a tax shelter or aggressive tax position would not retroactively compromise auditor independence.

2. ***The Board should clarify that the reference to "planning" and "opining" in Proposed Rule 3522 should not include routine tax planning and compliance services.***

As the Board stated, routine tax planning services provided by an audit firm generally would not compromise auditor independence. In fact, these services serve to promote audit quality because the auditor will have a better understanding of the client's tax position. Tax return preparation services including development of ancillary return information, *e.g.*, research and experimentation credit tax studies, cost segregation studies, depreciation studies, etc. are clearly part of the tax compliance process. Similarly, advising on tax return positions lacking clarity is an essential component of tax return compliance services. However, the broad scope of Proposed Rule 3522 could be interpreted to prohibit certain routine tax-related services that do not call into question an auditor's independence and which should be allowed to continue. As such, we believe that the final rule should be clarified to expressly permit these auditor-provided tax services.

Proposal:

- Proposed Rule 3522 should expressly provide that tax return advice and preparation, including advice pertaining to any required disclosures contained in an audit client's tax returns, do not constitute "planning" or "opining" for purposes of the rule.

3. *For the sake of clarity, "opining" should be specifically defined in the context of Proposed Rule 3522.*

Proposed Rule 3522 prohibits an auditor from "opining" on the tax treatment of three types of enumerated transactions. Although we agree that an audit firm should not provide tax opinions relating to tax shelters or aggressive tax positions described in Proposed Rule 3522, we believe that the Board should provide a definition of "opining" in order to provide greater clarity. We suggest that the definition specify that it applies to written opinions used for the purposes of avoiding penalties and mass marketed opinions.

Proposal:

- "Opining" should be defined as (i) the issuance of any written advice provided by an audit firm that is intended to be used by the audit client for the purposes of avoiding penalties for U.S. tax purposes or (ii) the issuance of any written advice by the audit firm to its audit client that might become provided in substantially the same form and substance to persons other than the audit client for the purpose of promoting, marketing or recommending a particular tax strategy for U.S. tax benefits.

C. The Board Should Clarify That The Rules Regarding Listed And Confidential Transactions Should Only Apply To The Tax Treatment Of Transactions Which Will Be Reported In U.S. Tax Returns.

Proposed Rule 3522 incorporates Treasury Regulations pertaining to disclosure requirements for U.S. federal income tax returns.[4] In particular, an auditor would not be considered independent if it provides non-audit services related to planning or opining on the tax treatment of a "listed transaction" within the meaning of Treasury Regulation Section 1.6011-4(b)(2) or a "confidential transaction" within the meaning of Treasury Regulation Section 1.6011-4(b)(3) (without regard to the minimum fee requirement set forth therein). In addition to specific suggestions relating to each of these types of transactions, described below, we are concerned that the application of U.S. tax law outside the United States may be unworkable.

We believe the three-prong test for aggressive tax positions in Proposed Rule 3522(c) adequately defines aggressive tax positions for auditor independence issues associated with foreign transactions, therefore providing a sufficient safeguard for excluding foreign transactions from these requirements.

The Treasury rule pertaining to listed transactions is designed to be applied to transactions for which the Internal Revenue Service (IRS) has publicly questioned the appropriateness of the U.S. tax benefits sought. There are a significant number of listed transactions and the contents of the IRS list changes frequently. A determination that a transaction is substantially similar to a listed transaction is a time consuming task requiring the exercise of considerable judgment because the terminology generally is highly technical and difficult to understand. Understanding of these rules by practitioners outside of the United States who do not practice in the area of U.S. tax is limited. Consequently, foreign issuers, audit committees and advisors would encounter great difficulty applying these rules, thus calling into question their utility in this context.

Similarly, the definition of a confidential transaction contained in Treasury Regulation Section 1.6011-4(b) (3) uses concepts that may be difficult to translate into legal systems outside the United States. Use of this tax definition with respect to transactions outside the United States raises questions of interpretation and application among foreign issuers, auditors and advisors.

Proposal:

- Listed and confidential transactions should impact auditor independence rules only with respect to the tax treatment of transactions which will be reported in U.S. tax returns.

D. Specific Comments Relating to Listed Transactions.

In addition to our comments of general application outlined above, we have specific suggestions relating to the portion of the rule relating to listed transactions. The

[4] It should be noted that the Treasury Regulations referenced by the Board in Proposed Rule 3522 only apply with respect to transactions where U.S. federal income tax benefits are being sought. See Treas. Reg. § 1.6011-4(c)(5) (defining "tax" for purposes of the Section 1.6011-4 regulations as limited to federal income tax).

proposed rules should be clarified further to address situations where tax planning evolves into a transaction that is viewed as listed or substantially similar to a listed transaction or is subsequently listed by the IRS.

1. Due to complexity, changing and iterative nature of listed transactions, the Board should clarify that the services provided by an audit firm before a transaction becomes listed do not compromise auditor independence.

The Board's release accompanying Proposed Rule 3522 seeks comment on situations in which a transaction planned or opined on by an audit firm becomes listed after the transaction is executed by the audit client. This question reflects the timing issue that arises due to the fact that the IRS can make determinations to list a transaction months or years after a tax advisor provides services in connection with the transaction. It also reflects a circumstance that is beyond the audit firm's control.

We believe that Proposed Rule 3522 should be clarified to provide expressly that auditor independence is not impaired in such a situation, assuming, of course, that the transaction initially passed the aggressive tax transaction test set out in Proposed Rule 3522(c). The subsequent listing of a transaction should not impact the independence of tax planning services that the audit firm provided before the listing. Moreover, we believe that any potential impact on future non-auditing services will be dependent on the facts of a particular matter. Matters of auditor independence in connection with any services provided after a transaction is listed (i.e., for a transaction that is in fact listed or is substantially similar to a listed transaction) should be referred to the audit committee in order for the committee to assess any auditor independence issues with respect to subsequent services.

Proposal:

- Proposed Rule 3522 should be clarified to provide that the rule relating to listed transactions applies at the time the auditor knows or reasonably should have known that a transaction was a listed transaction or substantially similar to a listed transaction. The subsequent listing of the transaction by the IRS should not impact the auditor's independence with respect to any services previously performed by it. The auditor must, upon the subsequent listing of the transaction, notify the audit committee in order to allow it to assess any auditor independence issues associated with the provision of any additional services with respect to the transaction.

E. Specific Comments Relating To Confidential Transactions.

We agree that an audit firm should not impose, directly or indirectly, conditions of confidentiality on advice to an audit client with respect to the U.S. tax treatment of a transaction.

1. To avoid instances in which the audit firm is unaware that the audit client or a third party has imposed a condition of confidentiality, the Board should allow the audit firm to rely on a written representation of the audit client.

There may be valid business reasons for an audit client or an independent third party to impose confidentiality requirements on a transaction, especially in connection with a merger or acquisition. In addition, a client or an independent third party advisor may impose conditions of confidentiality on the audit client after the audit firm provides advice with respect to the transaction. To avoid instances in which the audit firm would have no reason to know about the confidentiality requirement, we believe the audit firm should be able to rely upon a written representation of the audit client's CFO or tax director that neither the audit client nor any other advisor has imposed conditions of confidentiality on the client with respect to the U.S. tax treatment of the transaction.

This approach would be consistent with the meaning of confidential transaction under Treasury Regulations. Under those regulations, taxpayers (i.e., the audit client) would be required to disclose a transaction with respect to which any advisor that had received the minimum fees requested confidentiality. However, if multiple advisors are involved, the advisor demanding confidentiality is the only advisor that would be required to file an information return or maintain an investor list.

Proposal:

- The Board should allow an audit firm to rely upon a written representation of the client's CFO or tax director that neither the audit client nor another advisor has imposed conditions of confidentiality on the audit client to keep the U.S. tax treatment of the transaction confidential.

F. Aggressive Tax Positions.

We believe that the three-prong test articulated in Proposed Rule 3522(c) relating to aggressive tax positions is a helpful framework for distinguishing between permissible tax planning that does not give rise to auditor independence issues and aggressive tax planning that does present auditor independence concerns. We believe that further clarification of the three-prong test will better define this line. Below are clarifications we believe would improve the aggressive tax position test proposed by the Board.

1. ***The Board should adopt a bright line test for determining when an auditor must stop providing services because continuing such services would be in furtherance of an aggressive tax position.***

We believe that concerns about an audit firm's independence should be focused on two areas: (i) the audit firm bringing an aggressive tax position to an audit client, and (ii) the audit firm assisting an audit client in designing and implementing an aggressive transaction after determining (in light of a thorough analysis of tax law and the facts) that the audit firm would not issue an opinion concluding that the proposed tax treatment

would be at least "more likely than not" allowable under applicable tax laws. As previously noted, during the course of planning, the transaction may be further developed and the assessment may change. If the tax position shifts to less than "more likely than not", the audit firm should not continue to assist with the implementation of the transaction and independence should not be compromised at that point**.**

As such, we believe Proposed Rule 3522(c) should clearly define the point at which the audit firm may not provide services in furtherance of the planning or implementation of an aggressive tax position.

Proposal:

- Services in furtherance of the adoption or implementation of an aggressive tax position should be prohibited when the audit client has decided to pursue an aggressive tax position transaction and the audit firm has concluded after a thorough analysis of tax law and facts that it would not issue an opinion at a "more likely than not" comfort level. Services thereafter would be limited to those set out in Section II B.1, above.

2. *The rules related to aggressive tax positions should permit auditors to discuss the objective application of the tax laws to the client's circumstances in connection with routine tax advice and tax return preparation.*

Tax advisors in the United States are currently subject to standards of responsibility when advising clients as to matters of U.S. federal income tax law. For example, existing rules set forth a standard of "best practices" to which tax advisors should adhere when representing clients with respect to providing tax advice and preparing submissions to the IRS. Tax advisors routinely discuss with clients tax positions that could be taken by the client on their tax returns, but which may have varying degrees of certainty. The application of the tax laws to transactions, particularly complex transactions, is often unclear and entails varying degrees of risk, so that tax advisors are routinely called upon to assess various return positions, including those with less than a "more likely than not" level of comfort. Applicable rules relating to positions that are permitted to be taken on tax returns recognize this fact. For example, depending on the level of disclosure provided for in the return, taxpayers are permitted to take positions that are supported only by a "reasonable basis" or "substantial authority," both of which are levels of comfort less than "more likely than not"."[5]

In connection with tax return preparation, audit firms should continue to be able to advise clients as to levels of comfort associated with potential tax return filing positions even when the comfort is less than the "more likely than not" standard. We

[5] *See*, *e.g.*, Treas. Reg. § 1.6662-4(d) (1) (providing that substantial authority is ordinarily sufficient to avoid the substantial understatement penalty); Treas. Reg. § 1.6662-4(e) (providing that the substantial understatement penalty does not apply in certain circumstances if a position is adequately disclosed and has a reasonable basis).

believe that auditor independence is not compromised in these situations and that a finalized Proposed Rule 3522 should expressly so provide.

Proposal:

- An auditor should be able to advise an audit client on positions to be taken on the client's tax return regardless of the level of comfort reached by the auditor, provided that the position is properly disclosed on the client's tax returns if disclosure is required and provided that the position is not with respect to a transaction that was initially recommended by the audit firm.

3. *For the sake of clarity, the "more likely than not" standard should be defined.*

Although the "more likely than not" standard is set forth in Treasury Regulations, the definition of this standard could change over time. For clarity, particularly outside the United States, the Board should provide a specific definition in the final rules, rather than relying on Treasury Regulations that may change.

Proposal:

- "More likely than not" should be defined in Proposed Rule 3522(c) in order to provide maximum clarity and to avoid the possibility of the definition changing over time as U.S. tax rules change. The proposed tax treatment of a transaction should be considered to be at least "more likely than not" to be allowable under applicable law when, in the auditor's professional opinion, there is a greater than 50% likelihood that the final court of competent jurisdiction, in full possession of all the relevant facts and by reference exclusively to the legal merits of the case, would find in favor of the taxpayer if the tax treatment of the subject transaction were disputed between the taxpayer and the taxing authority.

G. Miscellaneous Issues.

1. Proposed Rule 3522 should apply to transactions involving U.S. federal, state and local income, franchise, sales, use, withholding and value added taxes.

Auditors provide tax-related services to their audit clients with respect to many different types of taxes assessable in various U.S. jurisdictions. Although income taxes tend to have the most significance to a client's financial statements, other types of taxes impact financial statements as well. As such, taxes should be defined to include these other types of taxes.

Proposal:

- Proposed Rule 3522 should provide that U.S. federal, state and local income, franchise, sales, use, withholding and value added taxes are taxes covered by the auditor independence rules.

2. Changes in the U.S. tax shelter rules should not affect the Board's rulemaking.

As discussed above, there are several instances where the Board adopts standards set forth in U.S. Treasury Regulations in determining whether an auditor is in violation of the independence rules relating to tax transactions. To the extent possible, we believe that the Board should objectively define these standards in the text of its rules such that the Board's standards will not change over time as Treasury Regulations change. This will produce clarity today and avoid the need to reconsider these rules over time.

Proposal:

- For the sake of clarity, the Board should define standards that are currently defined in U.S. Treasury Regulations in a manner consistent with the current definition of such terms.

3. *Terms should be used consistently in the final rules.*

Proposed Rule 3522 bans non-audit services related to planning or opining on the tax "treatment" of the three enumerated categories of transactions. The release accompanying the proposed rules references a ban on services related to planning or opining on the tax "consequences" (as opposed to "treatment") of the three enumerated categories of transactions. The final rules should clarify what services are prohibited by using consistent terminology.

Proposal:

- The ban on non-audit services should be confirmed to be on planning or opining on the tax "treatment" of the enumerated types of transactions.

III. TAX SERVICES FOR SENIOR OFFICERS OF AUDIT CLIENT – Proposed Rule 3523

A. The Board Should Adopt Proposed Rule 3523 With Certain Enhancements and Clarifications to Better Achieve The Board's Objectives.

We agree with the Board that services should not be provided by an audit firm to an officer in a financial reporting oversight role of an issuer and we support the objectives of proposed Rule 3523. The provision of services to these individuals can create the appearance of a conflict and we agree with the Board that they should not be permitted.

We would suggest that the Board expand the rule beyond a ban on tax services in furtherance of its objective. The Proposed Rule should prohibit all ***non-audit*** services to these individuals, not simply tax services, because provision of other non-audit services may similarly be perceived as creating a conflict. We also propose that the Board expand the rule to include close family members of covered officers for the same reason.

In addition to these proposed expansions of the rule, we offer a number of observations and comments to assist the Board in clarifying the rule to ensure consistent and appropriate application.

1. The rule should apply to all non-audit services provided by an auditor to individuals covered by the rule, not only tax services.

The purpose of the proposed rule is to address the perception of a mutuality of interest between auditors and certain senior members of management of an audit client who receive individual services from the auditor. We believe that this perception applies not only to tax services, but also to other non-audit services, such as those involving investment and personal financial planning. Moreover, if the proposed rule were to apply only to tax services, there may be doubt on the part of individuals covered by the rule as to the propriety of continuing to receive these other financial services from the audit firm. In order to address concerns over the appearance of a conflict, we recommend that the rule cover all non-audit services to affected individuals.

We do not believe, however, that the prohibition on non-audit services extends to services provided to companies in certain types of engagements (*e.g.*, advice to the corporate sponsor of a benefit plan), where a covered officer is merely one member of a group of employees impacted by the engagement. Such services may also include the provision of generic advice for all employees (*e*.g., employee handbooks, tax planning seminars for groups of employees and the like). Clarification on this point would provide beneficial guidance to audit committees so that they better understand the scope of Proposed Rule 3523.

Proposal:

- The rule should specify that a registered public accounting firm would not be independent if, during the audit engagement period, it provides any non-audit services directly to an individual covered by the rule.

- The rules should confirm that services provided to an issuer with respect to groups of employees that may include an officer in a financial reporting oversight role are not prohibited.

2. The rule should specify whether attribution rules would prohibit services to certain family members of officers in a financial reporting oversight role.

The proposed rule does not address whether the prohibition on services would apply only to the individual officers in a financial reporting oversight role, or whether it extends to those officers' relatives. We believe that the rule should be expanded to include certain family members in order to provide clarity and better achieve the objectives of the rule.

Proposal:

- The prohibition should apply to covered officers' spouses or spousal equivalents and their natural or adopted children under 21 years of age residing with the officer.

3. Auditors should not be prohibited from providing services to non-executive directors or audit committee members.

The rulemaking release invites comment on whether an audit firm's independence would be perceived to be impaired if it offered tax services to members of an audit client's audit committee or to other members of the board of directors. We believe that provision of services to non-executive directors, including audit committee members, does not impair independence.[6] The involvement of directors, and more particularly audit committee members, in the financial reporting process is in an oversight capacity only rather than day-to-day supervision, as opposed to officers in a financial reporting oversight role. Further, directors' standards of behaviour are defined in the context of their statutory, regulatory and fiduciary obligations to the company they govern and its shareholders. As such, the provision of services by the

[6] We also note that the discussion in the portion of the release related to international assignment services suggest that in addition to the service limitations imposed on the company, employees should consider the extent of services which are provided directly to them by the firm. Therefore, we recommend that the reference to employees be modified to include only those employees who are not in a financial reporting oversight role.

auditor to non-executive directors does not create a conflict and should not create the appearance of one.

We recognize that generally audit committee members have a closer relationship with auditors than do general directors. Therefore, the question related to services to audit committee members should be considered separately. We believe that allowing an audit firm to provide services to audit committee members does not undermine the objectives of the proposed Rule. Audit committees, like boards of directors, by their nature, act and make decisions as a group. Because audit committees act collectively, the fact that one member has retained the company's auditor to perform non-audit services is not likely to influence the decisions of the group.

Further, the Sarbanes-Oxley Act and Commission rules define clearly the responsibilities of the audit committee. These legal responsibilities are stringent, which reduces the likelihood that the performance of tax or other non-audit services for that audit committee member would impact their ability to perform their duties with respect to the auditor or the company. Finally, the risk of impairing independence must be weighed against the potential practical effect that a ban on services to audit committees -- some members sitting on multiple audit committees could face difficulty in receiving tax services from the firm of their choice, and as a result be less likely to accept audit committee service. We believe that, in light of the inherent protections against possible independence impairment, audit committee members should be allowed to use the services provider of their choice

Finally, we note that the form of corporate organization may differ in certain jurisdictions outside of the United States, where many companies have a tiered structure to their governing boards. These are generally split between non-executive and executive directors. We believe the same principles should apply regardless of the structure of a company's governing bodies, so that individuals functioning as non-executive directors, regardless of their title, would be exempt from the proposed rule.

Proposal:

- The rule should clarify that no independence violation occurs if a registered public accounting firm provides services to directors, including audit committee members, who do not otherwise serve in the management capacity as an officer in a financial reporting oversight role.

- The rule should clarify that no independence violation occurs if a registered public accounting firm provides services to directors serving in a supervisory only capacity in the context of a tiered board found in many foreign jurisdictions.

4. The rule should be clarified to apply to officers of an "issuer."

The Board has written the rule to apply to officers of an "audit client." We understand that those in a financial reporting oversight role of an issuer are generally

in a position to exercise influence over the content of the consolidated financial statements and over those who prepare them. We believe that to more appropriately reflect an individual's role in connection with the consolidated financial statements, the Board should change the definition to apply to those persons who are in a financial reporting oversight role at the issuer. As the SEC has indicated, in determining whether an individual is in a financial reporting oversight role with the issuer, the analysis would include looking at the role the individual is playing, his or her involvement in the financial reporting process of the issuer, and the impact of his or her role on the consolidated financial statements. (*See SEC FAQ "Application of the Commission's Rules on Auditor Independence,"* December 13, 2004)

Proposal:

- Proposed Rule 3523 should be modified to apply to officers in a financial reporting oversight role at an "issuer."

5. The rule should not apply to senior officers of affiliates of the audit client where the affiliate has a different auditor.

The proposed rule does not directly address the application of the prohibition in the context of investment company complexes and non-audit affiliates where the auditor providing the executive services does not audit the company employing the individual in question, but does audit an affiliate of that company or another entity in the same investment company complex. We believe that the rule should not apply to officers of an affiliate of the audited entity when that affiliate has a separate auditor. Such an affiliate would not be included in the consolidated financial statements of the company being audited by the firm and, therefore, an individual at that affiliate could not be in a position to influence those financial statements.

Proposal:

- The rule should specify that no independence violation occurs if a registered public accounting firm provides services to an officer of a separately audited entity which is affiliated with (or part of the same investment company complex as) the entity for which the registered public accounting firm serves as auditor.

B. The Board Should Give Further Consideration To Certain Transition Issues.

1. The rule should allow for the provision of tax services up to the effective date, as well as completion of tax returns and dealing with subsequent inquiries for all tax years ended before the effective date.

The rulemaking release indicates that there will be no independence violation for services provided to covered individuals in connection with original returns filed no later than the effective date. Covered officers may face uncertainty and potential transition hardships without further clarification by the Board and we suggest below a

number of possible solutions for the Board's consideration. Such clarifications will also assist audit committees and audit firms in complying with the rule.

First, in a number of foreign jurisdictions, taxable years do not correspond with the U.S. taxable years, with the result that tax returns in those jurisdictions for years ending during the course of 2005 may not be required to be filed with the appropriate taxation authority until after the proposed effective date of the rule. For instance, in the United Kingdom, the taxable year ends April 5, 2005, and returns are not due until January 31, 2006.[7] Under the proposed effective date, a covered officer residing in such a jurisdiction would not be permitted to continue to employ the audit firm as advisor for tax returns covering the most recently ended taxable year. This appears inconsistent with the Board's decision to choose an effective date falling after the latest date that an individual in the United States can file an extended return for income earned in the previous taxable year. We propose, therefore, that the effective date be extended so that services can continue to be provided with respect to all fiscal years ending prior to the effective date.

Second, because the effective date was chosen based on the extended return date for filing tax returns, it is unclear whether services to covered individuals would be permitted up to the effective date or only up to the filing of the tax return for the most recent fiscal year. It is also uncertain whether only services with respect to current or prior returns may be provided up through the effective date, or whether firms could continue providing services through the effective date related to later periods. Finally, the release may create uncertainty as to whether only tax preparation services, and not other tax services, may be provided up until the effective date.

Third, the rule does not address the situation in which a taxing authority opens for examination a prior year's tax return of a covered individual after the effective date of the rule. As a matter of fairness, we believe that the rule should permit covered individuals to continue to employ the same firm that provided original services relating to the re-opened return to assist in the resolution of the examination. Being forced to hire a different firm would prejudice the individual, since that new firm may have insufficient background and knowledge of the circumstances in existence at the time of the original filing.

Proposals:

- Firms should be permitted to complete tax services for covered individuals for all fiscal years ending prior to the effective date.

- All services, not just those related to return preparation, to individuals covered by the rule should be permitted until the effective date.

[7] A number of other Commonwealth countries have similar types of dates.

- If a firm prepared tax filings that are selected for examination by a taxing authority after the effective date, the covered individual should be permitted to engage the firm to assist with the response and resolution of the examination (not including any court proceedings) in order to prevent undue hardship to the affected individual.

2. *The rule should provide for a transition period for officers who come into a position that is a financial reporting oversight role after the effective date.*

The proposed rule and rulemaking release are silent as to when the rule would come into effect with respect to an individual who is promoted or hired into a position as an officer in a financial reporting oversight role, or achieves such a position by way of merger or consolidation activity, after the effective date of the rule. We believe that it would cause undue hardship to require an individual in such a situation to switch immediately to a non-audit firm provider of services. We believe that there should be a transition period to allow an individual sufficient time to hire a new advisor and, in the meantime, to continue to receive services from the individual's original advisor for an appropriate period. This concept is consistent with the Board's stated intent behind choosing an effective date for the rule that would allow individuals to continue receiving services through the latest possible filing of their 2004 returns.

Proposal:

- The rule should permit an individual who comes into a position as an officer in a financial reporting oversight role subsequent to the effective date, and who was receiving tax services from the audit firm, to retain the audit firm as his or her advisor through the filing of the tax return for the year in which the individual becomes subject to the rule. For purposes of full disclosure, the audit committee of the registrant should be informed of the existing relationship upon the individuals' accession to a covered position.

C. The Board Should Consider Additional Rule Clarifications.

We believe that there are a number of additional clarifications that will allow audit committees, covered officers, and audit firms to apply the rule consistently and appropriately. These clarifications are discussed below.

1. An audit firm should be permitted to provide services to trusts, other pass-through entities and charitable organizations in appropriate situations.

The proposed rule does not address whether a registered public accounting firm would be permitted to provide tax services to a trust or pass-through entity (which include partnerships, limited liability companies, S corporations and other disregarded entities that generally pay no taxes because items of income, loss, deduction, etc. flow through directly to the tax returns of their owners) in situations in

which an officer in a financial reporting oversight role at an audit client of the firm is a beneficiary, executive officer, partner or shareholder of such an entity. As a general matter, we believe that the rule should not impact the ability of the audit firm to provide services to these entities, so long as the covered officer of the audit client does not have a controlling interest in the entity. If the covered officer does have the potential to exercise control over the entity, we understand that there could be an appearance of an improper relationship between the auditor and the officer, as it could be perceived to result in a relationship similar to that which would exist if the audit firm was providing services directly to that individual. However, if the officer does not have the potential to control the entity, we do not believe that there is any potential conflict because the audit firm by definition is not performing services for that covered officer; the auditor's relationship is with a third party.

Similarly, we do not believe there would be any appearance of impropriety in situations where an officer of an audit client covered by the rule establishes a charitable organization to which the audit firm provides services. The control and governance of those organizations are heavily regulated and monitored by various agencies, including tax authorities. We believe that this level of government oversight and scrutiny dispels any appearance of conflict between the officer and the audit firm.

In the case of a trust, we believe that a registered public accounting firm should not be permitted to provide tax services to the trust if an officer in a financial reporting oversight role at an audit client of the firm is the trustee.

Proposal:

- An audit firm should be permitted to provide tax services to a pass-through entity of which a partner or shareholder is also a officer in a financial reporting oversight role at an audit client, so long as the officer does not have a controlling interest in the entity.

- An audit firm should be permitted to provide tax services to a charitable organization established by an officer in a financial reporting oversight role at an audit client. A firm also should be permitted to provide tax services to those organizations where the officer serves as a trustee or director of the charity.

- An audit firm should not be permitted to provide tax services to a trust if an officer in a financial reporting oversight role at an audit client is the trustee.

IV. RESPONSIBILITY NOT TO CAUSE VIOLATIONS – PROPOSED RULE 3502.

Proposed Rule 3502 would regulate the conduct of persons associated with a registered public accounting firm by prohibiting such persons from causing the firm to violate certain statutes, rules and professional standards due to an act or omission that the person knew or should have known would contribute to such violation. We support the Board's efforts to adopt meaningful and effective professional standards designed to hold the partners and staff of public accounting firms to a high standard of professionalism and ethical conduct. As we have stated many times, we share with the Board the goals of restoring investor confidence and public trust in our profession. While we believe that our partners and staff possess integrity, ethics and professionalism, as well as a collective commitment to audit quality, we support efforts by the Board to create greater trust and accountability in the profession as a whole.

We are concerned, however, that as drafted, the proposed rule is overly broad in scope and will lead to a number of potential unintended consequences adversely affecting public perception of the accounting profession and the quality of public company audits. Our primary concern is the Board's adoption of a standard of simple negligence for secondary liability. This would be in contrast to existing standards of secondary liability and create disharmony in regulating the conduct of accountants, thus leading to inevitable conflicts. We therefore urge the Board to consider carefully the appropriateness and potential implications of introducing a negligence standard for secondary liability.

We are also concerned by the potential application of the proposed rule to any person involved in any way, however remotely, with a firm violation. By failing to place any limitation on the establishment of causation by an individual of a firm violation, we believe the rule could be used in a manner that would not appropriately match conduct with sanction. We therefore further urge the Board to apply whatever rule is finally adopted only to those who directly and substantially cause a firm violation, rather than to anyone who could be seen to have been involved in any way in the chain of events leading to the violation.

Finally, if despite the concerns raised, the Board concludes that a negligence standard is an appropriate use of its authority, we recommend in the alternative that the Board take certain measures, outlined in Part C, below, that would limit the scope of the proposed rule to circumscribe its potentially far-reaching and unintended consequences.

A. Adoption of a Negligence Standard Would Have Significant Regulatory and Other Consequences.

Rather than advancing the Board's ultimate goal of enhancing audit quality, imposition of a negligence standard for secondary liability would instead lead to an expansion of authority granted by Congress confusion over the proper application of the

rule and disputes over the scope of the rule. It will also have a disproportionate effect on individuals subject to the rule and will lead to increased investigatory and sanctioning activity at the state level.

The Commission acknowledged important policy concerns when it declined to impose a negligence standard under Rule of Practice 102(e), the rule that enables the Commission to discipline accountants who engage in "improper professional conduct."[8] The Commission specifically rejected imposing a negligence standard because, among other things, it was concerned about the unintended consequences of creating such a rule, including the creation of an "undue fear" on the part of accountants that isolated errors in judgment would result in disciplinary action.[9] By doing so, the Commission did not condone negligence, but rather recognized that "a single error in judgment, even if unreasonable when made, may not indicate a lack of competence to practice," and it had other mechanisms to address and deter errors (*i.e.*, Section 21C of the Securities Exchange Act of 1934). We encourage the Board similarly to consider the potential unintended consequences of imposing a negligence standard for secondary liability especially since, in light of such unintended consequences, the Board can accomplish its objectives through other means, in particular through the inspection process, as discussed below.

1. The proposed rule's expansion of the scope of liability could indirectly expand the Commission's authority beyond that intended by Congress.

As the Board notes in its rulemaking release, Congress also has established effective standards for establishing secondary liability for individuals who cause a primary violation of the federal securities laws and rules.[10] The scope of that liability, ultimately subject to the control and wisdom of the United States Congress, has been ruled upon by the federal courts, including the United States Supreme Court.[11]

Under the proposed rule, the Board would be using its rulemaking authority to modify and expand the scope of secondary liability under the federal securities laws.[12] Among other things, such a rule could lead to division among the federal courts as to the appropriate scope of an accountant's potential liability under the federal securities laws and resulting confusion in enforcement of the rule. In addition, while the Commission was granted explicit Congressional authority under Section 20(f) of the Securities

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[8] The SEC revised Rule 102(e) to clarify the standard in the wake of judicial and public concern over the application of divergent standards by the Commission in its application of Rule 102(e). *See Checkosky v. SEC*, 23 F.3d 452, 462 (D.C. Cir. 1994); *Checkosky v. SEC*, 139 F.3d 221, 225 (D.C. Cir. 1998).

[9] See Amendment to Rule 102(e) of the Commission's Rule of Practice, 1998 WL 729201 (S.E.C. Release No. 33-7593).

[10] *See, e.g.*, Section 20 of the Exchange Act (Liability of Controlling Persons and Persons Who Aid and Abett Violations) and Section 21C of the Exchange Act (Cease-and-Desist Proceedings).

[11] *See Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 177 (1994) (finding nothing in the plain language of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder creating, and therefore no Congressional intent to create, aiding and abetting liability in that context).

[12] *Cf. Checkosky v. SEC*, 139 F.3d 221 at 225 (the adoption of a negligence standard "might be viewed as a back-door expansion of [the SEC's] regulatory oversight powers).

Exchange Act of 1934 to bring aiding and abetting claims, Congress was careful to circumscribe such claims to those based on knowing conduct. Since the Commission has the authority under Section 21(d) of the Exchange Act to enforce the rules of the Board, the proposed rule would have the effect of indirectly expanding the Commission's authority beyond that provided by Congress, allowing it to bring aiding and abetting claims based on simple negligence.

2. Reliance on Section 21C of the Exchange Act as the basis for a negligence standard fails to recognize the practical differences between the two provisions.

The Board suggests in a footnote to the rulemaking release that Section 21C of the Exchange Act and case law interpreting that provision serve as authority for adopting a negligence standard under the proposed rule. Section 21C confers on the Commission the ability to enter cease and desist orders against persons, including accountants, who cause violations of the securities laws due to acts or omissions that the person knew or should have known would contribute to the violation.[13] By employing identical phraseology (*i.e.*, "knew or should have known would contribute") in establishing secondary liability under the proposed rule, the Board claims justification for a negligence standard, ignoring the practical differences in the scope and purposes of the two provisions. Unlike the Board's proposed rule, Section 21C does not provide for individual sanctions or penalties. Rather, it provides only for cease and desist orders designed to prevent continuing or future violations. As such, there is no statutory or judicial basis for concluding that the same standards of conduct should apply to these two, separate provisions. There is, however, an established body of law to suggest that imposition of secondary liability is generally appropriate only when there is a showing that the individual's conduct alone was sufficient to cause a violation or that the individual actually knew that the actions of the primary violator constituted a violation.

3. Adoption of a negligence standard is not necessary to further the Board's ability to perform its supervisory function.

In establishing a program of continuing inspections of registered public accounting firms through Section 104 of the Sarbanes-Oxley Act of 2002 (the "Act"), Congress endowed the Board with a supervisory role to monitor compliance by firms and associated persons with relevant statutes, rules and standards. This was intended to be separate from the disciplinary function granted to the Board by Section 105 of the Act, which sets forth the sanctioning authority under the proposed rule. Based on the Board's December 14, 2004 open meeting, we understand that the proposed negligence standard is intended to aid in the fulfilment of the Board's supervisory function.[14] The inspection

[13] *See KPMG LLP v. SEC*, 289 F.3d 109, 120 (D.C. Cir. 2002).

[14] The rule "recognizes that the Board has not only disciplinary functions, but supervisory functions. And that, as a supervisor, we think it's appropriate for the Board to require that associated persons of a registered firm not merely refrain from knowing conduct that causes a violation, but also act with sufficient care to avoid negligently causing the violation. So, it's a recognition of a supervisory role as well as a purely

process already provides a sufficient and appropriate forum for the Board not only to monitor compliance with laws, rules and standards intended to promote audit quality, but also to discover and remedy potential non-compliance on a real-time basis. It is unclear as to how the adoption of a negligence standard can be viewed as assisting the significant effort that the Board has made in the inspection area.

4. The proposed rule is premised on an overstated distinction between the severity of available sanctions.

The Board notes in the rulemaking release that, while the rule is indeed intended to apply a standard of negligence, certain of the sanctions available to the Board under Section 105 of the Act can be imposed only for conduct that rises to a higher level of culpability. While this is a correct statement as a matter of law, it fails to recognize that *any* sanction imposed by the Board could have an extremely negative impact on an individual's career and would, therefore, lack proportionality to the ultimate level of culpability. Even those individuals whose conduct merited only the most "minor" sanctions under the rule would be faced with attendant consequences disproportionate to a negligence finding. Many audit clients might well be unwilling to accept an accountant whose record reflects a Board sanction, no matter how "minor." Further, certain states are contemplating adopting provisions that would require reporting to the state licensing boards any Board disciplinary proceedings.[15] The Board would also be required to report to state boards the commencement of Board disciplinary action, and in many cases, state licensing boards would be required to open an investigation, no matter how minor the violation. In deliberating the appropriateness of the negligence standard for secondary liability, the Board should recognize its potential practical consequences.

For all of the foregoing reasons, we believe that the Board should not impose a negligence standard for secondary liability on the associated persons of accounting firms, but should rather require that such persons act knowingly.

Proposal:

- The Board should modify the rule by deleting the phrase "should have known."

B. The Proposed Rule Should Apply Only to Individuals Whose Acts or Omissions Directly and Substantially Cause a Firm Violation.

The proposed rule provides that an individual shall not cause a firm violation through any act or omission that the person knew or should have known would "contribute to" the violation. The phrase "contribute to" does not afford a clear

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disciplinary role." *See Comments of Douglas Carmichael,* Transcript of the Public Company Accounting Oversight Board Open Meeting, Tuesday, December 14, 2004.

[15]Recent model rules established by the National Association of State Boards of Accountancy, for example, would require accountants to report to state boards the commencement of any PCAOB disciplinary action. Upon such notification, the state board would be obligated to open an investigation into whether the activity amounted to a violation of state rules. See,UNIF. ACCOUNTANCY RULES § 11-2(a)(5) (July, 2004).

understanding of the type of acts or omissions that may be held to cause a violation. We are concerned, therefore, that the rule could extend liability to any individual who was in any way involved in the chain of events leading to the violation. Much of the work in the accounting profession is performed on a collaborative basis, with numerous individuals participating in collective decisions involving a high level of professional judgment. Each such individual, however, may have a different role in the process and some will bear greater responsibility for the position ultimately taken by the firm. If the rule were interpreted broadly, each individual involved, however remotely, in the formulation of a decision or other action that ultimately leads to a violation by the firm could be held liable for causing the violation.

We do not believe it is the Board's intention to impose liability on all individuals in the chain of events at issue, no matter how remote, and, therefore, believe that the phrase "contribute to" should be clarified to apply only to individuals who directly and substantially caused the violation. This would enable the Board to continue to ensure that individuals are properly held responsible for actions of the firm, but would avoid a situation in which sanctions are imposed for a single violation on multiple individuals whose actions could only be considered a cause of the ultimate firm violation in a minor or attenuated sense. This would also appear to be consistent with the Congressional intent underlying Section 105(c)(6) of the Act, which recognizes that there are circumstances in which it would be inappropriate to impose liability on supervisory personnel who reasonably discharge their duties.

Proposal:

- The Board should amend the final clause of the proposed rule to read: ", due to an act or omission the person knew or should have known would *directly and substantially* contribute to such violation." (Emphasis added.)

C. If the Board Insists on Adopting a Negligence Standard it Should Adopt Measures to Limit the Scope of the Rule to Avoid Potential Unintended Consequences.

Although we strongly believe that a negligence standard is inappropriate in the context of the proposed rule, if the Board introduces such a standard, it should at a minimum modify the rule as suggested below to mitigate the potential for unintended effects of its enforcement.

1. The Board should not apply a negligence standard for secondary liability when the primary violation requires scienter.

The rulemaking release seeks comment on whether it would be appropriate to apply a negligence standard to an individual who contributes to a violation that would require that the firm knowingly or recklessly engaged in the misconduct. We strongly believe that this would be an improper and unwarranted application of the rule. The Board should not be in a position to sanction individual professional conduct that itself

would not rise to a violation of the underlying rule or professional standard and we fail to see any justification for holding an individual to a higher standard of conduct than that applied to the firm itself. Moreover, when an individual acts without scienter, it would appear incongruous to claim that that individual's conduct could be the cause of a violation that required at least knowledge or recklessness to prove. We therefore recommend that if the Board insists on imposing a negligence standard under the rule, it do so only in cases in which the primary violation could similarly be established by negligence. This represents a logical approach that is consistent not only with existing federal standards, but also with the common law application of aiding and abetting liability.

Proposal:

- The Board should specify that it will apply a negligence standard to individual conduct only when the violation by the firm caused by that individual's conduct does not require scienter.

2. The proposed rule should apply only to the Board's own rules and professional standards.

The rule proposal establishes liability for individuals who cause a primary violation by the firm not only of its own rules and of professional standards applicable to the accounting profession, but also to certain federal securities laws and rules promulgated thereunder. As we have noted above, there are already standards in place for establishing liability for individuals who cause a primary violation of these laws and the extension of the proposed negligence based rule would create a direct conflict with these standards and may also serve to expand the Commission's authority in this area in the absence of specific Congressional intent. To avoid this conflict and the inevitable costs that will arise in adjudicating resulting disputes, and to align the rule more closely with the Board's Congressional mandate to establish rules promoting quality control and ethics standards, the proposed rule should be limited to apply only to the Board's own rules and professional standards.

Proposal:

- The rule should be revised to refer only to violations of the Board's own rules (other than those adopting federal securities laws and rules) or professional standards.

PricewaterhouseCoopers Comment Letter Dated February 14, 2005

PROPOSED ETHICS AND INDEPENDENCE RULES CONCERNING INDEPENDENCE, TAX SERVICES, AND CONTINGENT FEES

PCAOB Release No. 2004-15, December 14, 2004; PCAOB Rulemaking Docket No. 017

Appendix

Proposed Rule 3524 – Audit Committee Pre-Approval of Certain Tax Services

Release No. 2004-015

Pg. 42 **Question #1**: Should additional information or documentation that is not described in Proposed Rule 3524 be provided to audit committees in the pre-approval process?

Answer: No. As stated in Section I. Subparagraph A. of our response, we believe audit committees should have the discretion to tailor their information and discussion requirements to the individual services at issue and should not be subject to requirements mandating that they review particular types of documents.

Pg. 43 **Question #2**: In addition to the communications required by Proposed Rule 3524, should auditors be required to have additional communications with the audit committee with regard to the tax advice that has been provided to the audit client?

Answer: No. As stated in Section I. Subparagraph A. of our response, periodic discussions and updates are becoming increasingly customary and are valuable in making sure the audit committees are informed of the status of engagements and have access to subject matter experts. We do not, however, believe there is any need to prescribe this with additional rules.

Pg. 29 **Question #3**: Should Proposed Rule 3522 address the possible impairment of an auditor's independence in situations where a transaction planned, or opined on by the auditor becomes listed after it is executed?

Answer: Yes. As stated in our response in Section II. Subparagraph D.1. – we believe that the subsequent listing of a transaction should not impair the independence of prior tax planning services and that Proposed Rule 3522 should be clarified to expressly state so in such a situation.

Pg. 29 **Question #4**: Does Proposed Rule 3522(a) adequately describe a class of transactions that carry an unacceptable risk of impairing an auditor's independence?

Answer: Yes. However, as stated in our response in Section II. Subparagraph C, we believe that Proposed Rule 3522(a) should be applied only where United States federal, state or local tax benefits are expected from the transaction.

Pg. 31 **Question #5**: Should confidential transactions be treated as *per se* impairments of a registered public accounting firm's independence from an audit client?

Answer: No. As stated in our response in Section II. Subparagraph E, we believe the rule should be limited to those conditions of confidentiality that are related to the tax treatment of a transaction reported on a U.S. tax return and the audit firm should be able to rely on a representation of the client CFO or tax director that there are no conditions of confidentiality.

Pg. 31 **Question #6**: Should other provisions of the Treasury's regulation on reportable transactions, other than the provisions of listed and confidential transactions, be incorporated by reference in the Board's rules on tax-oriented transactions that impair independence?

Answer: No. We believe other provisions of the Treasury's regulation on reportable transactions should not be incorporated in the Board's rules on tax-oriented transactions that impair independence. These regulations are intentionally broad and are not intended to apply only to aggressive tax transactions because their purpose is to facilitate the goal of a robust disclosure regime.

Pg. 35 **Question #7**: Is the term "initially recommended by the registered public accounting firm or another tax advisor" sufficiently clear?

Answer: Yes.

Pg. 35 **Question #8**: Is there a better way to describe aggressive tax transactions, strategies, and products that a registered public accounting firm ought not to sell to an audit client?

Answer: Yes. As stated in our response in Section II. Subparagraph F.I., we believe the three-prong test articulated in Proposed Rule 3522(c) is a helpful framework for distinguishing between permissible tax planning and aggressive tax planning. The framework should be clarified to improve the application of the test by adopting a bright line test for determining when an audit firm must stop providing services.

Pg. 35 **Question #9**: Does the "more likely than not" standard draw the right line between aggressive tax strategies and products that a registered public accounting firm ought not to plan, or opine on the tax treatment of, for an audit client and routine tax planning and advice?

Answer: Yes. As stated in our response in Section II. Subparagraph F, we believe that services should be prohibited when the auditor has concluded, after a thorough analysis of tax law and facts, that it would not issue an opinion at a "more likely than not" comfort level. However, we believe that an auditor should be able to advise the audit client on tax return filing positions that may not meet that level of comfort.

Pg. 35 **Question #10**: Should the Board require a registered public accounting firm to obtain a third-party tax opinion in support of the tax treatment, if the potential effect of the treatment could have a material effect on the audit client's financial statements?

Answer: No. Proposed Rule 3522 sets forth an appropriate framework for auditor independence with respect to tax shelter and aggressive tax positions. Requiring a third-party opinion does not assure auditor independence and would not absolve the auditor of independence concerns associated with tax shelters and aggressive tax positions.

Proposed Rule 3523 – Tax Services for Senior Officers in a Financial Reporting Oversight Role

Release No.
2004-015

Pg. 37 **Question #11**: Are there other classes of employees to whom an accounting firm should not offer tax services?

Answer: No.

Pg. 37 **Question #12**: Would a registered public accounting firm's independence be perceived to be impaired if it offered tax services to members of an audit client's audit committee, or to other members of the audit client's Board of Directors?

Answer: No. As indicated in our response in Section III. Subparagraph A.3, we believe that the provision of services to non-executive directors, including audit committee members, does not impair independence.

Proposed Rule 3502 – Responsibility Not To Cause Violations

Release No.
2004-015

Pg. 19 **Question #13**: Are there categories of circumstances encompassed by the rule as proposed that should not be encompassed by the rule for some reason?

Answer: Yes. While we believe that a negligence standard is not the appropriate standard to discipline associated persons, if the Board decides to adopt the negligence standard, we believe that there are certain categories of circumstances that should be excluded. The proposed rule should apply only to individuals whose acts or omissions directly and substantially cause a firm violation. Further, the proposed rule should apply only to the Board's own rules and professional standards.

Pg. 19 **Question # 14**: In a circumstance in which a firm is found to have committed a violation that requires that the firm knowingly or recklessly engaged in the misconduct, would it be appropriate to find a Rule 3502 violation by an associated person who negligently contributed to the violation?

Answer: No. We believe that this would be an improper and unwarranted application of the rule. The Board should not sanction individual professional conduct that itself would not rise to a violation of the underlying rule or professional standard.

PCAOB Release No. 2004-15 Section I

Release No. 2004-015

Pg. 17 **Question #15**: Are there any independence concerns for the types of services discussed in the Section I. of Release No. 2004-15 that the Board has not identified?

Answer: No. Based on what's happening in the market place as well as analyses of recent corporate scandals, the rule addresses the problematic services.

Pg. 17 **Question #16**: Are there other types of services that could appropriately be included in the discussion in Section I. of Release No. 2004-15?

Answer: Yes. We believe services previously considered by the Commission should be set out in the Release. This will facilitate audit committee reference and use when the services are discussed in a single guidance document. Other services that could appropriately be included in the Release include assisting the audit client with the obtaining of a revenue ruling, private letter ruling or similar administrative guidance from the IRS or other competent tax authority. These services should not implicate the auditor independence rules, regardless of the nature of the transaction for which a ruling is sought. Many of these matters we would regard as routine tax compliance, *e.g.*, a foreign company that requires advance clearance to make payments with deduction of withholding taxes, and some we would regard as a normal part of general tax planning work on business transactions, *e.g.*, in the United Kingdom obtaining routine clearances when companies are acquired on a share-for-share basis. We do not consider that the obtaining of such rulings or advance clearances should pose any independence concerns and should fall within the ambit of acceptable tax services discussed by the Board. In addition, securing such rulings establishes appropriate comfort with respect to the transaction, thereby eliminating any auditor independence issues.

Proposed Rule 3520 – Auditor Independence

Release No.
2004-015

Pg. 20 **Question #17**: Would the scope of the ethical obligation described impose any practical difficulties?

Answer: Yes. The way the rule is currently written, it would subsume the independence rules enforcement of territories outside the United States, in effect, placing the PCAOB in a position of enforcing IFAC and other rules. The Board should restrict the obligation to conduct with respect to registrant and United States rules.