ERNST & YOUNG
5 Times Square
New York, New York 10036
Phone: 212 773-3000

VIA ELECTRONIC SUBMISSION

July 24, 2006

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

Re: PCAOB Rulemaking Docket Matter 19

Dear Sir/Madam:

Ernst & Young LLP ("EY") is submitting this letter to provide its comments on the Proposed Rules on Periodic Reporting by Registered Public Accounting Firms (PCAOB Rulemaking Docket Matter No. 019), PCAOB Release No. 2006-004 (May 23, 2006) ("Release").

EY is the U.S. member firm of Ernst & Young Global Limited, which has member firms throughout the world, of which 65 have registered with the PCAOB. The comments below reflect the views both of EY and our global organization.

I. Comments on Proposed Form 2:

As a general matter, we appreciate the Board's efforts to limit the reporting requirements to "meaningful" information (Release at 2), that is, information that might be useful to the Board in its conduct of its statutory obligations, such as its inspections of the firms, as well as to the investing public and others who need access to important information about registered firms. However, we believe that there are a number of areas where the Board might make the requirements more practical, while at the same time serving the objectives stated by the Board. These are as follows:

1. **Item 3.2 – The Firm's Revenues.** The proposal would require that the firm provide information on its revenues during the annual reporting period, which under the rule would be April 1 through March 31. The rule would require that the firm determine its total fees "billed" to clients during the reporting period, and then to disclose what percentage of the total fees were billed to issuer clients for audit services, other accounting services, tax services, and non-audit services.

   We recommend that, to avoid confusion, the disclosure categories conform to the SEC's proxy fee disclosure requirements, which require disclosure of audit fees, audit-related fees, tax fees, and all other fees. Using the proxy fee disclosure information would be consistent with the approach taken in the firm's registrations. In the Frequently Asked Questions Regarding Registration with the Board, issued November 13, 2003, the Board permitted the firms to use the proxy fee data as "reasonable estimates" of the firm's revenues in these buckets.

   Assuming the disclosure categories were made to conform to the SEC's proxy rule requirements, we would propose making these disclosures based on the proxy information relating to our clients' fiscal year that ended during the most recent April 1 through March 31 reporting period. In other words, we ask that we be permitted to make this disclosure based on information that our clients accumulate for annual proxy fee disclosure purposes, even though the time period covered by these annual disclosures generally will not precisely reflect the fees billed during the April 1-March 31 reporting period. To the extent we do not have available to us complete information as of our June 30 filing date (for example, we likely will not have complete proxy fee information by June 30 for a March 31 calendar year-end company), we would make reasonable estimates.

   Also, compliance with this reporting requirement (as well as others, such as those relating to the number of firm personnel) would be eased considerably, particularly for non-U.S. PCAOB registrants, if the Board were to permit firms to adopt their own reporting period. Many non-U.S. accounting firms registered with the PCAOB are also subject to oversight by a domestic body comparable to the PCAOB which have their own annual reporting requirements. In many cases the PCAOB works with the domestic oversight authorities in the timing and planning of their inspection activities. It would be burdensome for an accounting firm to collect similar types of revenue and personnel information at two different points in a year. Accordingly, we suggest that the Board provide flexibility for all PCAOB registrants in determining the reporting period, or at least provide that where a non-U.S. firm is subject to oversight by a domestic body that coordinates its inspection activities with the PCAOB, the firm can report for the same period and at the same effective date used to meet the domestic requirements.

In addition, we note that Item 3.2 is captioned "The Firm's Revenues," but the text of the item refers to "total fees billed." These are two different amounts. We believe the item should refer to revenues rather than to billed amounts.

2. **Item 4.1 – Audit Reports Issued by the Firm.** Item 4.1(b) would require that the firm provide "the total number of Firm personnel who exercised the authority to sign the Firm's name to an audit report during the reporting period." We question the relevance or significance of the number of partners who actually sign the firm's name to an audit report. This number would exclude partners who have significant roles on audits but do not serve as the lead engagement partner on an audit of an issuer during the particular reporting period. We suggest that the Board instead require disclosure of the total number of assurance partners in the firm – in other words, partners who are organizationally part of our core assurance practice.

3. **Item 5.2 – Audit Related Memberships, Affiliations, or Similar Arrangements.** Item 5.2.a.2 and 5.2.b would require that the firm provide the name and address, and a description, of any membership or affiliation "in or with any network, arrangement, alliance, partnership or association that markets or sells audit services or through which joint audits are conducted." Item 5.2.a.3 requires similar information for any "affiliation" with another entity, "whether by contract or otherwise," through which the firm "commonly employs or leases personnel to perform audit services, or with which the Firm otherwise engages in an alternative practice structure."

   We think this proposal requires some clarification. In particular, it is unclear what might be meant in this context by the word "commonly" or the phrase "alternative practice structure." We suggest that the Board's adopting release describe what these terms mean.

4. **Item 6.1.d – Number of Firm Personnel.** Item 6.1.d would require disclosure of the number of persons who provided audit services during the reporting period "segregated by functional level." A Note to this Item states that this information must be provided for persons who "were with the Firm at the end of the reporting period," and the Note further states that "functional levels" may consist of "partner, senior manager, manager and audit staff." This proposal would require that we report the number of all persons who did any work whatsoever – even one hour of work – on an audit of an issuer. Thus, it would sweep in many persons who we do not consider to be audit personnel, such as information technology, tax, and valuation personnel, if such persons participated in one or more audits. But,

at the same time, it would not include members of our core assurance practice who did not participate in the audit of at least one issuer during the reporting period. As noted above in connection with Item 4.1, we believe that a more relevant number would be the number of all persons by functional level who are part of our core assurance practice.

5. **Part VII – Certain Relationships.** Part VII includes several disclosure requirements relating to persons who, or entities which, have certain relationships with the registered firm. The instructions to Form 2 state that "in the first annual report that the Firm files after having an application for registration approved, the Firm should provide this information for the period running from the date used by the Firm for purposes of General Instruction 9 of Form 1 (regardless of whether that date was before or after the beginning of the reporting period) through March 31 of the year in which the annual report is required to be filed." This would mean that EY would be required, in its first annual report filed June 30, 2007, to provide information covering, in addition to the period April 1, 2006 through March 31, 2007, the period covering June 30, 2003 through March 31, 2006. (Non-U.S. members of our global organization registered later than did the U.S. firm, so the catch-up period would be somewhat shortened.)

This "catch-up" requirement would be difficult to complete accurately. This is because it would require information about *former* partners and employees – that is, persons whose employment (or partnership) at the firm only existed for some period of time between June 30, 2003 and March 31, 2006. Assuredly, we would be able to determine the identity of any such persons who had been sanctioned by the SEC under Rule 102(e) prior to joining our firm (a disclosure required by **Item 7.1**), because such a situation would be very unusual. But **Item 7.2** would require us to disclose information about individuals who joined the firm from another *public accounting firm* that had been, within the prior five years, suspended or denied the right to practice before the Commission. We have not maintained information of this nature, and it would be quite difficult to trace the employment heritage of the many thousands of professionals who we have hired since June 30, 2003. This is particularly the case because the proposal would require us to perform a person-by-person search of the personnel files of *former* colleagues – persons who came and left during the June 30, 2003- March 31, 2006 period. And, making matters more difficult, the proposal as worded would require the reporting of persons who were partners or employees at firms "at the time of the conduct giving rise" to the sanctions. Thus, Audit Staff Person X could have joined EY in 2004 after working at Firm Y from 2000 to 2004. In 2005, Firm Y might be the subject of an SEC Rule 102(e) suspension order relating to conduct by someone at Firm Y (not Audit Staff Person X) in 2001. Under these circumstances, we would be required to report Audit Staff Person X in Item 7.2. Such information would be difficult to track both retroactively and prospectively, and would not be useful, either to the Board or the investing public.

The "catch-up" would also apply to **Item 7.4,** which would require us to disclose whether we entered into any "contractual or other arrangement to receive consulting or other professional services" from an individual or entity who has been the subject of a Rule 102(e) sanction by the SEC or certain disciplinary sanctions by the PCAOB. It would be difficult to capture the "catch-up" information required under Item 7.4, because we and other EY member firms purchase consulting and other professional services from hundreds of outside vendors.

As to **Item 7.4,** we have concerns other than the "catch-up" requirement. The term "consulting or other professional services" is quite vague. It could be made clearer and narrower by referring to services specifically in support of an audit engagement. Also, we believe that, as proposed, the associated compliance costs will substantially outweigh the benefits, particularly with respect to non-U.S. firms. Firms (both U.S. and non-U.S.) will be required to put in place compliance procedures to identify the situations where a vendor relationship is being contemplated with the provider of professional services (*e.g.*, a law firm or outside lawyer) who has, within the prior five years, been sanctioned in a Rule 102(e) proceeding. Such contemplated relationships are likely to be rare, but we question whether it is worthwhile to require firms, in particular non-U.S. firms, to identify them and, if the relationship is entered into, report them to the Board. Given the many vendor relationships entered by EY member firms both within and outside the U.S., we urge reconsideration of this proposal unless it is narrowed as we have suggested.

6. **Item 8.1 – Acquisition of Another Accounting Firm or Substantial Portions of Another Accounting Firm's Personnel.** Item 8.1.c. would require a registered firm to state whether it "took on" 75% or more of the partners, shareholders, principals, members, or owners of another "accounting firm." We note that there may be instances where a firm meets this 75% requirement, but does so over a multi-year period. It is not clear from the rule whether it is intended to capture such a situation, but, if it does, keeping track of multi-year hiring developments may be difficult.

Also, we note that the term "accounting firm" has not been defined by the PCAOB, but there is a definition in the SEC independence rules. The SEC defines the term as "an organization . . . that is engaged in the practice of public accounting and furnishes reports or other documents filed with the

Commission or otherwise prepared under the securities laws . . ." 17 C.F.R. §210.2-01(f)(2)(2005). We think that definition could be used here.

7. **Item 9.1 – Affirmation of Understanding of, and Compliance with, Consent Requirements.** Items 9.1(b) would require that we affirm that the registered firm has "secured from each of its associated persons, and agrees to enforce as a condition of each such person's continued employment by or other association with the Firm, a consent indicating that the associated person consents to cooperate in and comply with any request for testimony or the production of documents made by the Board in furtherance of its authority under the Sarbanes-Oxley Act of 2002, and that the associated person understands and agrees that such consent is a condition of his or her continued employment by or other association with the Firm."

   As to this requirement, Item 9.1(b) includes, at Note 2, a reference to potential foreign legal impediments. The Note reflects the fact that during the registration process many non-U.S. accounting firms submitted legal opinions explaining that impediments exist with respect to the employee cooperation agreements that were required to be obtained by registering non-U.S. firms, and which would also be the subject of the Item 9.1(b) consent. We are raising this issue merely to note for the Board that those legal impediments still exist.

II. Comments on Proposed Form 3:

Form 3 would require the filing of special reports within 14 days of the occurrence of specific events. Release at A-28. We have several comments.

1. **General Comments:** We have four general concerns. *First*, the proposed rule includes a "catch-up" requirement. This would require a registered firm to make retroactive filings with respect to all of the disclosure items in Form 3, even though no firm would have had reason to accumulate this specific information in the past in order to satisfy these disclosure requirements. As discussed above regarding Part VII of Form 2, this will be a burdensome requirement for certain of the disclosure requirements, in particular **Items 2.1, 2.6, and 2.9.** We discuss these and other items in greater detail below.

   Second, a number of Items – **Items 2.4, 2.5, 2.6, 2.7. 2.8, 2.9, 2.10, 2.14, and 4.1** – require the filing of a Form 3 where "the Firm has become aware" of a specific matter or event. The same language is used in Proposed Rule 2205, relating to amendments to Forms 2 or 3 that must be made to fix errors or omissions in these filings.

This phrase raises compliance concerns. EY has more than 30,000 partners and employees in the United States, and several of the other member firms have many thousands of employees. In such large organizations, there almost certainly will be relevant matters that are known to some person or persons that are not known to others. In particular, the firm's management – who understand and have responsibility for the firm's PCAOB reporting obligations – might not always be made aware of relevant information. It is not clear whether the rule would impose a reporting requirement where knowledge of a particular matter resides solely with a staff or staff persons. Even if it is not so broad, it might nonetheless impose a reporting requirement whenever any partner in the firm is "aware" of a particular reportable event. In this regard, we note that under partnership law principles, knowledge of one partner is generally imputed to the partnership as a whole. Moreover, the word "aware" is rather imprecise. It certainly lacks the sort of legal significance and definition that can be attached to the word "knows" or "knowledge."

Accordingly, we suggest that the items containing the phrase, "The Firm has become aware . . . ," be restated. They might instead read, "If, to the knowledge of the firm's management" a particular event has occurred, then the reporting obligation is triggered. We note that a similar formulation appears in analogous SEC regulations. For example, Item 5.01 of Form 8-K, "Changes in Control of Registrant," states, "If, to the knowledge of the registrant's board of or officers, directors, a committee of the board of directors or authorized officer of a registrant, a change in control of the registrant has occurred," then a report must be filed.

It might be suggested that such an alternative approach would encourage some firms to take an ostrich-like approach to important matters so as to avoid filing Form 3s. We think that unlikely to happen, but if it were to occur the Board could appropriately address the matter through the inspection process. Also, our suggested alternative uses the word "management," which admittedly is hard to define in a large firm such as ours. We think this might reasonably be addressed by the Board in its adopting release, where the Board might explain that the word refers generally to senior persons in a firm's national offices. That approach still would be imprecise, but we think it is nonetheless preferable to the more imprecise and impractical "Firm becomes aware" language in the proposal. In this regard, we note the definition of "management person" that is contained in the SEC regulations relating to investment advisers. It states (17 CFR §275.206(4)-4): "Management person means a person with power to exercise, directly or indirectly, a controlling influence over the management or policies of an adviser which is a company or to determine the general investment advice given to clients." The Board might consider using a similar "controlling influence" standard here with respect to the reporting obligations. Also, if the Board were to take this approach, we think it would be appropriate for the Board to state in its adopting release that it expects firms to put in place some internal reporting systems so that senior persons in the firm are made aware of reportable events.

Third, we are concerned that the 14-day reporting period would, for certain of the reportable events, be too short. In this regard, the disclosures relating to license suspensions or revocations (Items 2.14, 2.15) and to the initiation of certain legal proceedings (Items 2.5-2.10) are similar to what are now required by many state boards of accountancy. However, most state boards have a 30-day reporting window, and some have a 45-day period. Consistent with these approaches, we urge the adoption of a period of time longer than the proposed 14 days, such as 30 or 45 days.

Fourth, Items **2.6, 2.8, 2.9, 5.1,** and **5.2** impose various reporting obligations when "a partner, shareholder, principal, owner, member or manager of the Firm" is connected to certain pending or concluded legal proceedings. As the Board knows, the term "manager" is typically used by accounting firms to refer to staff persons at a particular experience level, that is, persons who are not owners or partners of the firm. We assume that the Board did not intend to apply the disclosure requirement to such staff persons, and instead was intending to refer to persons who have an ownership interest in the firm. We ask that the Board clarify this matter.

2. **Items 2.1 and 3.1, Withdrawn audit reports and consents, and Items 2.4 and 4.1, Unauthorized Use of Firm Name.** Under Items 2.1 and 3.1, a firm would be required to file a Form 3 whenever a firm has withdrawn an audit report, or withdrawn its consent to use its name in a report, document, or written communication containing the issuer's financial statements, and the issuer has failed to comply with the reporting requirements of Item 4.02 of Form 8-K. Items 2.4 and 4.1 would require that the firm file a report when an issuer "in a report, document or written communication containing the issuer's financial statements" has used the firm's name without the firm's consent. As to these particular Items, the Board has stated that it "particularly encourages commenters" to express their views. (Release at 10).

We recommend that the Board not adopt these elements of proposed Form 3. We do, of course, share the Board's desire that investors receive timely information about significant financial reporting issues. But these are matters relating to issuer misconduct, and accordingly they strike us as matters that should be addressed by the SEC rather than the PCAOB. The SEC might properly provide additional guidance in this area, or might issue new rules, or might bring enforcement cases against issuers that have been violating the existing rules. We would certainly support such efforts by the SEC.

If the Board were to adopt these requirements, we note that the "catch-up" aspect would also cause compliance difficulties, because we have not collected this information. Moreover, it is unclear what purpose the "catch-up" requirement would serve, since it would require the reporting of very old news to investors.

We also want to address one aspect of the Board's discussion of this issue. In the Release (at page 11), the Board stated that this new Form 3 reporting obligation might be "unnecessary" because of the "illegal acts" reporting obligation under Section 10A(b) of the Exchange Act. The Release goes on to state that the Form 3 requirement is necessary because "many registered firms faced with these reportable events may not recognize that the circumstances involve the type of illegal act that triggers the obligations set out in Section 10A(b)." And, the Release states, "even if a firm does address these issues through the Section 10A(b) process, that process would not necessarily ensure that relevant information would become public as quickly as it would pursuant to the proposed Form 3 reporting." We note for the Board that Section 10A reports are non-public, so there is no question that an accounting firm's obligations under Section 10A(b) would not achieve the Board's goal of quicker public disclosures of restatements. In addition, there may be interpretive issues under Section 10A(b) that would make the application of Section 10A less straightforward than the proposing release would suggest.

3. **Item 2.6 – Certain Legal Proceedings**. Item 2.6 would require the filing of a Form 3 report when the firm becomes aware that specified persons within the firm have been charged with certain criminal offenses. We have two comments on this proposal.

First, the list of criminal charges for which reports must be filed includes any crime of "dishonesty." Because criminal misconduct is, by its very nature, "dishonest," it would be difficult to distinguish between criminal allegations involving "dishonesty" and those that do not. We suggest that the word be stricken.

Second, a Form 3 must also be filed where a person has been "charged with any crime arising out alleged conduct that, if proven, would bear materially on the individual's fitness to provide audit services to issuers." We believe this description is too vague. It would likely be particularly difficult for non-U.S. firms to interpret. We do not believe it is necessary; the list of specific crimes listed in the Item, such as fraud, embezzlement, forgery, and so on, seems quite sufficient. If, over the course of time, the Board concludes that there are certain gaps in this list, the Board could make appropriate additions to the rule.

4. **Items 2.7 and 2.8 – Certain Legal Proceedings.** Item 2.7 would require a Form 3 filing whenever the firm becomes a defendant or respondent in a government proceeding if the matter relates to the provision of "professional services for a client." Item 2.8 applies this same requirement when partners and other specified persons are named in a government proceeding.

   Both Items 2.7 and 2.8 use the term "professional services" rather than audit services, and "client" rather than issuer. This would mean that a government proceeding completely unrelated to the provision of audit services, involving a non-public entity, would be reported on Form 3. This strikes us as too broad. In this regard, the comparable provision in Form 1, Item 5.1, is much narrower – it required disclosure of government proceedings arising out of the registered firm's "conduct in connection with an audit report, or a comparable report prepared for a client that is not an issuer." We urge a similar approach be taken here.

* * *

Please contact us for further information on any of the issues discussed above. In addition, we would like to suggest to the Board that, after final rules are in place, we be given an opportunity to provide the PCAOB's staff with our insights on certain of the technical aspects of data submission, so that the electronic reporting of information might be made as efficient and error-free as possible.

Respectfully submitted,

Ernst + Young LLP

Ernst & Young LLP