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

Re: PCAOB Rulemaking Docket Matter No. 004
Statement Regarding the Establishment Of Auditing and Other Professional Standards

Deloitte & Touche LLP is pleased to respond to the request for comments from the Public Company Accounting Oversight Board (the "PCAOB" or the "Board") on its *Statement Regarding the Establishment of Auditing and Other Professional Standards*, PCAOB Rulemaking Docket Matter No. 004 (April 18, 2003). We support the goals of the Sarbanes-Oxley Act of 2002 (the "Act") to restore investor confidence, as well as the Board's efforts to faithfully implement the Act.

Introduction

One of the core duties of the Board, as determined through the Act, is to "establish or adopt, or both, by rule, auditing, quality control, ethics, independence, and other standards

relating to the preparation of audit reports for issuers....”¹ The standard setting process is a substantial undertaking and will hold great significance to not only the accounting profession but also to issuers and investors. In this comment letter we have identified those aspects of the Board’s proposal that we believe should be clarified or modified to help ensure that the Board’s standards are applied appropriately, that the Board’s standard setting process considers meaningful input from all interested parties, and results in standards that promote effective audits for issuers.

The Board’s Authority Relates to the Audits of Issuers

The release of the proposed rule states that “Rule 3100 would require all registered public accounting firms to adhere to the Board’s auditing (and related attestation), quality control, and ethics standards, and its independence rules, *in connection with the preparation or issuance of any audit report for an issuer* (as defined in the Act).”² This is consistent with Section 103 of the Act, which states that the Board has the duty to establish “auditing, quality control, ethics, independence, and other standards relating to the preparation of audit reports for issuers....”³ Although we believe it is the intention of the Board to faithfully implement this Section of the Act, the text of the proposed rule could lead one to believe the Board’s standards have a broader scope beyond the audits of issuers because the text of the proposed rule does not specifically refer to the audits of issuers. We do not believe it is the intention of the Board for registered public accounting firms, which are also actively involved in performing engagements for non-

¹ See Act, § 101(c)(2).

² PCAOB Release No. 2003-005, at p. 2 (emphasis added).

³ See Act, § 101(c)(2).

issuers, to be required to follow only those standards adopted by the Board. Still, as currently written, the text of the proposed rule is overly broad and could be misinterpreted by auditors, issuers, and the public.

To illustrate, Rule 3100 refers in the title to “Professional Auditing Standards Applicable to Registered Public Accounting Firms” and states, “a registered public accounting firm and its associated persons shall comply with all applicable professional auditing standards” (as defined and established by the Board).⁴ This proposed text is problematic because as written, it would supercede auditing, ethics, and independence standards set by other regulatory bodies such as the United States General Accounting Office, international bodies such as the International Auditing and Assurance Standards Board, other non-U.S. governmental regulatory bodies, individual states within the United States, as well as standards applicable to the audits of private companies. However, in the performance of audits of non-issuers, registered accounting firms may be required to follow these other standards not promulgated by the Board. Read literally, the proposed text would require that once a firm becomes registered it would be required to follow standards set by the Board and unable to follow standards set by other bodies in carrying out the audits of non-issuers. This would result in the audits of certain non-issuers being found in violation of other U.S. regulations and the laws of many countries. The same issue exists with respect to PCAOB Release No. 2003-006, *Establishment of Interim Professional Auditing Standards*.

⁴ PCAOB Release No. 2003-005, at A1-i.

Based on the above, and because it is critical that the text of the rules be precise and specifically refer to the audits of issuers, we recommend that the current wording in the proposed rule be modified such that the title of Rule 3100 refers to “Professional Standards Applicable to Registered Public Accounting Firms in Connection with the Audits of Issuers” and that the text of Rule 3100 clarify that the Board’s standards apply to registered firms in connection with the preparation of audit reports for issuers. This wording is consistent with the duties of the Board as established by the Act and the discussion of the proposed rule during the Board’s open meeting on April 16, 2003. Additionally, we also recommend that PCAOB Release No. 2003-006, *Establishment of Interim Professional Auditing Standards*, be clarified in a similar manner.

The Board Should Create a Detailed Framework for the Standard Setting Process In Order to Facilitate Meaningful Input

The Board’s release states that the proposal sets forth a “general process” in establishing standards.⁵ However, we believe that in order to facilitate a meaningful, orderly standard setting process, a detailed framework and process for standard setting including the use of the standing advisory group as well other advisory and ad hoc task forces needs to be developed and included in the text of the rule. Although the discussion in the release language provides some detailed information including how potential changes to standards may arise, the potential for open meetings and roundtables depending on the nature of the proposals, and the use of an exposure process, such details are not included in the text of the proposed rule. The proposed text also does not include many of the procedural aspects of the standard setting process. A detailed framework within the text of the Board’s rule is critical to enable all participants and the public to understand the workings of the Board and to facilitate the standard setting process.

⁵ PCAOB Release No. 2003-005, at p. 3.

A detailed framework for the Board’s standard setting process should include three elements. First, the detailed framework should include a structure under which issues will arise, the agenda will be developed, and the standards will be proposed, deliberated, exposed for comment, and adopted. Second, the detailed framework should include a discussion of the procedural aspects, such as the frequency and nature of the meetings of the Board as well as its standing advisory group, the terms of the members of the advisory group, and the group’s interaction with the Board. Third, the detailed framework should consider different levels of guidance as well as a process for dealing with urgent or emerging issues. Additionally, the detailed framework for the Board’s standard setting process should be based on the principle of due process – which would include an open process of discussion, debate and resolution of issues at public meetings, active solicitation and consideration of the views of various constituencies through the exposure process, and publication of dissenting views.

The framework described above is similar to the standard setting process followed by the Financial Accounting Standards Board (the “FASB”). The FASB “follows an extensive ‘due process’ that is open to public observation and participation; this process is modeled after the Federal Administrative Procedures Act, and in some ways is more demanding.”⁶ To establish its agenda, the FASB uses factors such as: pervasiveness of the issue, technical feasibility, practical consequences, convergence possibilities, cooperative opportunities, and availability of resources. The FASB follows an open decision making process which includes publication of its agenda, public announcement of its meetings and future calendar, open Board meetings with open debate of issues, and exposure of proposed standards for public comment. Exposure drafts set forth the

⁶ “Facts About the FASB 2002-2003,” <http://www.fasb.org/>.

proposed standard, the proposed effective date and method of transition, background information, an explanation of the basis for the Board’s conclusions, and alternative views, if any. FASB often uses a 60-day exposure period, sometimes shorter or sometimes longer depending on the complexity of the standard. The FASB describes its exposure period as “a search for new information and persuasive arguments regarding the issues; it is not simply a ‘nose count’ of how many support or oppose a given point of view.”⁷ Additionally, in order to keep the public informed of its activities, the FASB releases a weekly notice through its “Action Alert” which is posted on the FASB website and provides notice of upcoming meetings, the agendas of the meetings, and brief summaries of actions taken at previous meetings. The FASB still has the flexibility to add dates and agenda items, but such changes are announced as soon as known. Through the entire process the public and all interested parties are kept informed of the FASB’s activities and are able to participate in the process.

Based on the principles for the detailed framework recommended above, we have the following suggestions. First, the Board should adopt a step-by-step outline for the standard setting process similar to the process followed by the FASB. Such a process should include the elements described above including how issues will arise, how the agenda will be developed, and how the standards will be proposed, deliberated, exposed for comment, and adopted. This process should include open discussion, debate and resolution of issues at public meetings. It should also include active solicitation and consideration of the views of various constituencies through the exposure process. Such an exposure period should be longer than the 21 days that is discussed in the Board’s release; 21 days is too short to provide meaningful input to the standard

⁷ *Ibid.*

setting process. The process should also include the method to be used for handling all comments, including providing to the public an analysis of the reasoning as to the disposition of such comments. Additionally, once the standard is finalized by the Board and published on its website it should be made clear in such posting that the standard is still subject to approval by the Securities and Exchange Commission (the “SEC”) and it should include dissenting views of the Board, if any.

Second, the Board and its standing advisory group should conduct regularly scheduled open meetings. The dates for such meetings should be established in advance and published on the Board’s website, along with the agenda items, so that the public and other interested parties can plan to attend. The Board should also clarify how it intends to use the standing advisory group and other groups and task forces. The development of ethics, independence, quality control and auditing standards require different expertise. As such, the Board should consider creating different standing advisory groups for each area. Additionally, terms for advisory group members should be established.

Third, the Board should establish different levels of guidance. The highest authoritative level should be the standards as set by the Board and approved by the SEC. At a lower level, the Board should consider issuing interpretive guidance that could be less formal and perhaps outside the rule-making process in order to address emerging and urgent issues. This interpretive guidance could be developed by the staff and perhaps reviewed by the advisory board. Such interpretations would not be binding as standards but would be very helpful to practicing auditors.

Adopting a detailed yet flexible framework as described above will create a method by which meaningful input can occur and will help facilitate the standard setting process.

All Advisory Groups Should Include Active Members of the Auditing Profession

The text of Rule 3700 (b), which describes the composition of the standing advisory group, states that the advisory group will include individuals with expertise in public company auditing, among other individuals. We understand based on the discussion in the proposed release that it is the intention of the Board to include practicing auditors among the constituencies in the standing advisory group. Active consideration of the issues from the perspective of those who will have to execute the standards will be essential to effective implementation of the Board's standards. As such, we suggest that the Board clarify Rule 3100 (b) to state that practicing auditors will be among the individuals included in the advisory group. Additionally, although the composition of other advisory groups and ad hoc groups is not detailed in the proposed rule, we firmly believe that practicing auditors should be included on any such groups.

The proposed rule also states that members of the standing advisory group would be subject to certain provisions of the Board's Code of Ethics (provisions EC3, EC8(a), and EC9). We agree that the members of the advisory group should be required to adhere to these provisions of the Code of Ethics in carrying out their advisory activities for the Board. While we do not believe adhering to the provisions of EC8(a) would be problematic for members of the accounting profession serving on the advisory group, we are concerned that the language in EC8(a) could be used to criticize the Board for placing practicing auditors on the advisory group, simply because they are subject to the Board's oversight, and on that basis alone, do not have the necessary "appearance of independence and objectivity with respect to the Board's function or

activities.”⁸ Therefore, we recommend that the Board revise the language in both Rule 3700(e) and EC8(a) so that it is clear that those who practice in a registered public accounting firm and serve on an advisory group would not be automatically considered to lack the “appearance of independence and objectivity” merely because they are subject to the oversight of the Board.

“Professional Auditing Standards” Should Not Encompass Standards other than Auditing Standards

The Board has proposed to define the term “professional auditing standard” to include any auditing standard, standard for attestation engagements, quality control policy or procedure, ethical or competency standard and independence standard.⁹ Currently each of those standards is referred to separately by specific name (e.g., “auditing standards” and “independence standards”) by both the SEC as well as the accounting profession. To combine all of these separate standards and refer to all of them as “professional *auditing* standards” will confuse all parties involved – investors, the public, issuers, and auditors. Additionally, the Act defines the term “professional standard” to include accounting principles as well as auditing standards, standards for attestation engagements, quality control policies, ethical and competency standards, and independence standards.¹⁰

Therefore, we recommend that the Board replace the proposed term “professional auditing standard” with the term “professional standard” to be consistent with the Act and to avoid confusion among all parties. We further recommend that the phrase “professional

⁸ PCAOB Release No. 2003-004, at A1-vii.

⁹ PCAOB Release No. 2003-005, at A1-i.

¹⁰ See Act, § 1000A (a)(10).

standards for the audits of issuers” be used by the Board to refer to all standards that are to be followed in the audits of issuers.

Conclusion

An effective standard setting process is critical to the mission of the Board. We believe that adoption of the recommendations included herein would enhance the proposed rule and, as discussed above, help to ensure that the Board’s standards are appropriately applied, that the Board obtain meaningful input from all interested parties, and the process results in standards that promote effective audits for issuers.

* * *

We appreciate the opportunity to comment and would be pleased to further discuss the Board’s proposed rule. If you have any questions or would like to discuss these issues further, please contact Robert J. Kueppers at (203) 761-3579.

Very truly yours,

/s/ Deloitte & Touche LLP

cc: Charles Niemeier, Acting Chairman of the PCAOB
Kayla Gillan, Member
Daniel Goelzer, Member
Willis D. Gradison, Jr., Member