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August 18, 2003

Via E-mail

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. 006**

Members and Staff of the Public Company Accounting Oversight Board:

We are pleased to provide our comments regarding the Board's proposed rules on inspections. Generally, we believe the proposal reasonably reflects the provisions of the Sarbanes-Oxley Act of 2002 ("the Act"). However, there are various provisions of the proposed rules that we believe should be modified to provide clarification and otherwise enhance the effectiveness and efficiency of the inspection process, while continuing to protect the public interest. Our comments are as follows:

Inspection Approach

Proposed Rule 4001 requires reviews of engagements performed at various offices of a registered firm. This approach appears to be similar to the current peer review model. In that regard, we suggest that the Board consider utilizing the guidelines for engagement selection, scope, and risk-based questionnaires used in the current AICPA SEC Practice Section peer review process. These guidelines and tools have been developed over many years with significant practical benefits and have been accepted by the staffs of the Public Oversight Board and SEC. We believe use of this material would enhance the rapid implementation of the inspection program within a framework that would meet the public interest and is one that is most familiar to those involved in the process. Of course, we would expect the Board to tailor such material to reflect current concerns and risks, with subsequent modification reflecting new professional standards and changes in the environment.

We also suggest use of an approach for those firms subject to annual inspection that would entail (1) in the first year after the firm is registered, reviews of the design of its quality control policies and procedures and a sample of audit workpapers and (2) in each of the next two years (a) review of changes in the firm's quality control policies and procedures, including ensuring that appropriate changes were made to comply with new professional standards and (b) on-site "piggyback" reviews of the firm's internal inspection program. This cycle would repeat itself in the fourth year. We believe such an approach would ensure continuous monitoring of registered firms on an annual basis, while making the best use of the resources available to the Board.



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We also recommend that the inspection practices attempt to maximize the continuity of reviewers assigned to a particular firm. For larger firms requiring annual inspections, substantial time is needed to become sufficiently familiar with the firm's audit policies and procedures and the nature of its public company clients to perform an effective review. Once that level of knowledge is obtained, it should be preserved to the fullest extent possible.

Finally, we strongly urge the Board to have inspections conducted outside of the traditional time of the year that the firm conducts the majority of its audits. This would enable firms to complete the audits within the accelerated deadlines recently enacted, maximize the availability of non-staff reviewers (see below), and avoid the disruptions that would otherwise result.

#### Inspection Resources

Proposed Rule 4000 provides for the Board to authorize non-staff persons to participate in inspections. In that regard, we recommend that such potential resources include current partners and managerial employees of public accounting firms, acting either through review teams representing such firms or through suitably qualified individuals from various firms coming together to form a coordinated group. In either case, these reviews should be closely directed by representatives of the Board's staff. This structure would ensure that appropriate and sufficient technical resources (including industry expertise) are brought to bear on the significant inspection effort, while ensuring the public interest is protected by requiring the direct involvement of the Board's staff in managing the inspection, including final decision-making regarding key issues that arise during the process.

We would be pleased to provide appropriate technical resources to assist the Board with inspections.

#### Integration with Peer Reviews of the Non-issuer Portion of a Firm's Audit Practice

As the Board is aware, various states require a triennial peer review of a firm's audit practice in order to maintain its licensing credentials. It does not appear that limiting these reviews to a firm's SEC practice would fulfill the peer review requirements of the states. Accordingly, since we understand that the Board's inspection program is intended to focus only on audits of issuers, a firm will need to ensure that the non-issuer portion of its practice is subjected to an external peer review under an acceptable program. We urge the Board to work with the accounting profession and the National Association of State Boards of Accountancy in establishing a coordinated inspection program under which the Board's inspection of issuers and the external peer review of non-issuers can be integrated with a



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minimum of redundant effort, thereby reducing the substantial out-of-pocket costs and diversion of technical resources that would otherwise occur.

#### Correction of Quality Control Defects

We agree with the proposal to provide firms 12 months to correct quality control defects or criticisms described in an inspection report. This acts as an incentive for firms to correct these matters on a timely basis, while still providing the Board with the ability to monitor how the firm implements its corrective actions, thereby protecting the public interest. However, we also believe that the Rule should recognize that some deficiencies may be so egregious that they may need to be corrected in a shorter time period.

In connection with the Board's procedures to review evidence of firm corrective action, we believe it is important for Rule 4009 to explicitly require communications between the Board and the firm during the 12-month period (rather than only after the firm formally submits its evidence), to enhance the ability of the firm to modify its corrective action to satisfy interim concerns of the Board. Otherwise, a firm could face the prospect of the Board's rejection of its corrective action and the consequent loss of reputation and potential inability to audit issuers. Similarly, we recommend that the rule require the Director to issue a draft report for review by the firm within a reasonably prompt prescribed time frame after submission of the firm's evidence of corrective action before making his or her recommendation to the Board.

Proposed Rule 4009 provides for public disclosure of criticisms 15 days after a firm formally requests Commission review unless the Commission directs otherwise. With all of the SEC's other responsibilities, it appears that 15 days is an unreasonably short period to expect it to review a final Board decision. We suggest that a longer period (e.g., 30 days) would be more realistic in the circumstances.

#### Violation of a Firm's Quality Control Policies

Proposed Rule 4004 and Section 104 of the Act seem to equate violations of a firm's own quality control policies with violations of the Act or professional standards. While violation of a firm's own quality control policies may be indicative of a weak quality control environment, which should be the subject of corrective action, we are concerned that elevating the implications of such violations may have the counterproductive effect of providing a disincentive for firms to adopt policies that exceed professional standards, but represent best practices. Accordingly, we strongly urge the Board to indicate explicitly in the Rule or Appendix 2 that it will exercise appropriate judgment when addressing a firm's violations of its own policies when it otherwise complies with professional standards.



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While the proposed Rule implicitly provides that criticisms that the firm has addressed to the Board's satisfaction will not be made public, we believe this provision should be made explicitly. Moreover, since, under Proposed Rule 4008, final inspection reports and possibly an additional letter or comments are to be sent to certain states or other licensing authorities, such authorities should be notified by the Board if it ultimately determines that a firm has satisfactorily addressed the criticisms or defects. Otherwise, these authorities might be operating under the false assumption based on the report it originally received that there continue to be unresolved defects at the firm.

#### Review of Drafts

Proposed Rule 4007 provides that prior to issuing a final report reflecting a firm's response letter, the Board may, at its discretion, afford the firm the opportunity to review the draft. We believe it would always be appropriate to afford firms such opportunity. In addition, we recommend that the reference to the draft inspection report also include reference to any additional letter of comments.

We do not understand the circumstances under which the Board would direct that the transmission be deferred. This should be clarified.

#### Special Inspections

Item A2 of the Overview indicates that special inspections will be conducted as necessary to address issues that come to the Board's attention, including through informal means such as informants and news reports. We would expect that the nature and extent of such inspections would be reflective of the nature of the source of the information. Accordingly, we believe that sources such as anonymous tips or uncorroborated media stories ordinarily should initially precipitate informal questions of the firm, as opposed to a formal inspection. We suggest that such guidance be incorporated in the final Rule 4002.

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A credible inspection process is a critical element of the Board's oversight role. We appreciate the efforts that have been and will be undertaken by the Board in translating the provisions of the Act into a practical approach to implementing a highly complex inspection process. In that regard, we stand ready to assist the Board, where appropriate. Moreover, we applaud the Board for its willingness to continue to dialogue with its foreign counterparts to achieve the goals of the Act without unnecessary burdens being placed on foreign firms.



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We also appreciate this opportunity to express our views to the Board. We would be pleased to answer any questions the Board or its staff might have about our comments. In that regard, please contact Wayne Kolins at 212-885-8595 or via electronic mail at [wkolins@bdo.com](mailto:wkolins@bdo.com).

Very truly yours,

/s/ BDO Seidman, LLP

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