



August 20, 2003

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

Re: PCAOB Rulemaking Docket Matter No. 006

Members and Staff of the Public Company Accounting Oversight Board:

The SEC Practice Section (“SECPS” or the “Section”) of the American Institute of Certified Public Accountants (“AICPA”) respectfully submits the following written comments on the Public Company Accounting Oversight Board’s (“PCAOB” or the “Board”) proposed rules regarding the inspections of registered public accounting firms. The AICPA is the largest professional association of certified public accountants in the United States, with more than 350,000 members in business, industry, public practice, government and education. The AICPA bylaws require, among other things, that all members that engage in the practice of public accounting with a firm auditing one or more SEC clients as defined by AICPA Council are required to be members of the SECPS. There are approximately 1,100 firms that are members of the SECPS, which consists of approximately 750 firms that audit registrants that file financial statements with the U.S. Securities and Exchange Commission (the “Commission”) and approximately 350 firms that have joined voluntarily. All of the Section’s member firms are U.S. domiciled accounting firms. Neither the AICPA nor the SECPS has the jurisdictional authority to require firms domiciled outside the U.S. to join as members.

With the enactment of the Sarbanes-Oxley Act of 2002 (the “Act”), SECPS member firms that audit issuers and are registered with the Board will be subject to regular and special inspections as the Board may from time-to-time conduct. The SECPS seeks to assist its member firms in fulfilling its responsibilities required under the Act. To that extent, the SECPS appreciates the opportunity to comment on the Board’s proposed rules on inspections of registered public accounting firms.

The SECPS supports the PCAOB in its efforts to fulfill its responsibilities of performing inspections of registered accounting firms as required by the Act. However, the Section believes the proposed rules could be clarified and improved in several respects. Most importantly, the proposed rules do not provide any clarity or guidance to registered public

accounting firms about the content of the inspection plans so that firms are aware of the criteria against which they are being measured. To further complicate the process, the proposed rules do not provide any clarity about the roles and responsibilities of the various parties involved in the inspection process.

In consideration of the Section's overall observations, the Section offers the following specific comments on the proposed rules:

Rule 4000 – General

The proposed rule provides that inspection steps and procedures will be performed by the Division of Registration and Inspections staff, “and by such other persons as the Board may authorize to participate in particular inspections or categories of inspections.” While not expressly stated in the proposed rule, we assume that any “such other person” would be required to adhere to PCAOB Release No. 2003-008, *Ethics Code for Board Members, Staff and Designated Contractors and Consultants* (“Ethics Code”). Accordingly, the Section recommends that the proposed rule make reference to adherence to the Ethics Code by any “such other persons.” Further, the Section recommends that the Board provide guidelines as to those circumstances under which any “such other person” would be participating. The Section assumes that any “such other person” would only be participating to assist the Board in fulfilling its inspection responsibilities.

Rule 4002 – Special Inspections

The note to the proposed rule states “the Board may authorize a special inspection on its own or at request of the Commission.” First, we recommend that the Board provide due notice to firms once special inspections have been authorized. Second, we recommend that the Board clarify what is meant by the phrase “the Board may authorize” as it is unclear whether one Board member, a majority, or the full Board is necessary for authorization. The Section assumes that a majority vote is required by the Board, and recommends that the language in the proposed rule be clarified in this regard. Finally, we recommend that the Board provide greater specificity regarding the circumstances surrounding the commencement of special inspections.

Rule 4003 – Frequency of Inspections

The proposed rule states that a regular inspection will be performed at least once in every three calendar years for firms that issued an audit report with respect to one, but no more than 100 issuers, or that played a substantial role in the preparation or furnishing of an audit report with respect to at least one issuer. For firms that audit more than 100 issuers, the Board will perform a regular inspection on an annual basis. With the exception of firms that audit more than 100 issuers, the frequency of such inspections will be similar to the SECPS membership requirement as it relates to peer review. The Section has required that its member firms submit to peer review of its accounting and auditing practice every three years. In addition to the Section, approximately 35 States require peer review for licensure. The Section plans to continue its peer review program since many States require peer review of firms' entire

accounting and auditing practices, and the PCAOB inspections will only cover firms' SEC or issuer practices. However, the Section's peer review program will primarily focus on firms' non-SEC practice, as the PCAOB will be performing inspections or reviews of firms' SEC or issuer practices.

Since firms that are registered with the PCAOB will need both a PCAOB inspection and an SECPS peer review of its non-SEC practice, the Section believes it is important that the SECPS peer review program can be coordinated with the efforts of the PCAOB. The Section recognizes the hardship for firms having to undergo two reviews in order to meet both federal and state requirements. Accordingly, we encourage the Board to retain firms' pre-existing peer review cycles, to the extent possible, to assist the Section in coordinating the SECPS peer reviews with the PCAOB inspection activities.

Rule 4004 – Procedure Regarding Possible Violations

The note to the proposed rule states "the Board may, as appropriate, make referrals other than those specifically described in Rule 4004." We recommend the Board establish guidelines for such other referrals, as the language is currently vague and could lend itself to severe consequences for firms and its associated persons for minor infractions. For instance, there is no discussion regarding the materiality of matters subject to referral or on what basis referrals will be made. Under the proposed rule, it appears that even possible violations will be referred. The Section recommends that the Board provide guidelines under which referrals will be made. Further, the Section assumes that referrals will only be made as they relate to audits of issuers, and not to all audits, since the Board was only given authority under the Act with respect to audits of issuers. Accordingly, the Section recommends that the proposed rule include language clarifying that referrals will only be made as they relate to audits of issuers.

Rule 4005 – Record Retention and Availability

The Board did not provide for record retention guidelines in its proposed rule. The Section-by-Section Analysis states "The Board is reserving this rule in anticipation of issuing standards on record retention as part of its standard setting process once it has experience with its inspection program." The Section recommends that the Board provide guidelines to ensure consistent application in record retention by registered firms, particularly relating to firms' internal inspection records (such as offices visited, engagements reviewed, review checklists, etc.). SECPS member firms have been required to adhere to AICPA Quality Control Standards, which state in part that "A firm should prepare appropriate documentation to demonstrate compliance with its policies and procedures...Documentation should be retained for a period of time sufficient to enable those performing monitoring procedures and a peer review to evaluate the extent of the firm's compliance with its quality control policies and procedures." The SECPS Peer Review Program Manual further states "At the conclusion of an inspection [firm internal inspection], only the inspection summary or report should be retained until the team captain on the firm's next peer or quality review has the opportunity to review that summary or report. Typically, all detailed working papers should not be retained

after that summary or report is prepared. However, the detailed working papers on an inspection may be retained for a longer period if the firm expects the peer reviewer or quality reviewer to consider the inspection program to reduce the scope of the peer review or quality review. (Typically, reviewers of smaller firms will give little or no consideration to inspection due to the scope requirements and cost/benefit considerations.)” Since retention of internal inspection reports varies depending on the nature and size of the firm, and since detailed working papers of the inspection are typically not retained once the inspection summary or report is prepared, the PCAOB should consider establishing guidelines in this area if the Board has an expectation that is different from prior practice.

Rule 4006 – Duty to Cooperate with Inspectors

The proposed rule requires registered firms and their associated persons to cooperate with the Board. Such cooperation “shall include, but is not limited to, providing access to, and the ability to copy, any record” of the firm as requested. As currently written, we believe the rule is extremely broad and could lead to disagreements between inspectors and firms. We recommend the Board formalize its policy on the information that the Board may request, and recommend that the Board insert “relevant or material” before “record.” Further, the Board should consider privacy issues that demand particular care with respect to confidential treatment (such as tax returns, employment information, communications with legal counsel regarding pending or threatened litigation, etc.). We also recommend that any such copies received be subject to the same retention requirements that are applicable to registered firms, so that the Board does not maintain copies for a period longer than the firms.

Rule 4007 – Procedures for Firm Review of and Response to Draft Inspection Report and Issuance of Final Inspection Report

The proposed rule provides for the Director of the Division of Registration and Inspections, at the conclusion of each inspection, to submit to the Board a written draft report. The proposed rule does not discuss parameters on what is to be included in the report, including thresholds, materiality, etc. We believe it is imperative that the Board establish inspection and reporting standards to ensure consistency in performance and reporting on inspections.

The proposed rule also states that the “Board may, in its discretion, afford the firm the opportunity to review any revised draft inspection report” (underline added for emphasis). We strongly recommend that the Board explicitly provide firms with the opportunity to review and respond to all revised draft reports. Accordingly, we suggest that the phrase in the proposed rule be modified to state the “Board shall afford the firm the opportunity to review and respond to any revised inspection report.”

Finally, the proposed rule does not address the time period from the conclusion of the inspection to the presentation of the draft inspection report to the Board. It is unclear if presentation to the Board is normally to occur on the next business day or at any time during the year. Since completion of the inspection report is critical to firms in meeting their state licensing requirements, as those reports will need to be provided to the states, we recommend

that the Board establish protocols with respect to the timing and completion of inspection reports.

Rule 4008 – Transmittal of Final Inspection Report

The proposed rule states that any report transmitted by the Board to the Commission and/or to each state, agency, board or other authority that has issued a license or certification number authorizing the firm to engage in the business of auditing or accounting “may be accompanied by any additional letter or comments by the Board or the Board’s inspector that the Board deems appropriate.” In the spirit of fairness, the Section believes that firms should be afforded the opportunity to review and comment on any additional letters or comments by the Board, similar to the review process that is afforded to firms with respect to draft inspection reports.

Rule 4009 – Firm Responses to Quality Control Defects

The proposed rule, as well as the Act, makes reference to “criticisms of, or potential defects in, the quality control systems of the firm under inspection.” Since such matters are to be publicly reported if not corrected by firms under inspection, we believe it is of utmost importance that the Board define what is meant by this phrase. If not defined, there may be confusion in matters that are reported to the public. For instance, it may be difficult for the public to distinguish the difference between minor infractions and those that are significant. Accordingly, we strongly encourage the Board to define what is meant by the phrase “criticism of, or potential defects in, the quality control systems of the firm under inspection.”

The proposed rule provides for the Director of the Division of Registration and Inspection to “advise the firm whether he or she will recommend to the Board that the Board determine that the firm has satisfactorily addressed the criticisms or defects in the quality control system of the firm identified in the final inspection report and, if not, why not.” As currently drafted, firms are to provide evidence to the Director that previously identified quality control defects have been corrected, and the Director then makes a recommendation to the Board. After the Director receives such evidence from the firm, he or she could determine that such evidence is insufficient and makes such recommendation to the Board. However, if the firm was made aware of this fact, the firm should have an opportunity to provide additional evidence to the Director, which may lead to a very different outcome. As currently drafted, the proposed rule does not provide firms with the ability to provide additional information to the Director. Accordingly, we recommend that firms be provided with ample and sufficient opportunity to provide any additional information or clarification to the Director prior to the Director’s recommendation to the Board.

The proposed rule contains a provision that no criticisms of, or potential defects in, the quality control system of a firm under inspection will be made available to the public, unless the firm failed to correct such criticisms or defects within 12 months after the date of the inspection report. Because of the importance of such confidentiality provision, which was recognized in the Act, the Section recommends that the proposed rule further clarify that firms should

likewise be required to withhold the report for 12 months. The Section has a concern that despite the confidentiality that is afforded in the Act, external parties may try to seek such information by obtaining it from the firm and circumvent the remedial aspects of the process set forth in the Act. The Section strongly encourages the Board to mandate that firms keep such reports confidential until the reports are made publicly available by the Board.

The proposed rule provides that a firm has “12 months after the issuance of the Board’s final inspection report” to remedy any criticisms of, or potential defects in, the quality control systems of the firm. It is unclear what is meant by “issuance” of the Board’s final inspection report. Is this the date the report is issued or the “as of” date of the report? There could easily be a six-month or longer difference, thus possibly giving a firm just a short window to correct deficiencies that existed “as of” the inspection date. For instance, if the PCAOB inspects a firm as of March 31, takes several months to perform the inspection, and issues the report on September 30, does the firm have 12 months from September 30 or from March 31 to correct matters? The Section assumes that it would be the September 30 date; however, given the importance of this matter, the Section strongly encourages the Board to clarify the timing to avoid any confusion and to ensure firms are provided with a full 12 month period to correct any matters noted from the Board’s inspection activities.

Further, the reporting portion of the proposal does not describe how many reports a firm may receive as a result of the Board’s inspection activities. The Section assumes that the Board will issue a single report upon completion of a regular inspection. Use of multiple reports on a single firm’s inspection could create misunderstanding and render it more difficult to coordinate with the Section’s peer review activities with respect to the audits of non-issuers.

Finally, the proposed rule does not address the period the firm’s inspection report will remain in the public records. The Section recommends that only the current report remain in the public records since it is the only report of significance as it is most representative of the firm’s current ability or “fitness” to perform audits of issuers.

Rule 4010 – Board Public Reports

The proposed rule provides that “the Board may, at any time, publish such summaries, compilations, or other general reports concerning the procedures, findings, and results of its various inspections as the Board deems appropriate.” The proposed rule further states “no such published report shall identify the firm or firms.” The Section agrees that the Board should not identify the firm or firms, and encourages the Board to be cautious in its publication of such reports so that the firm or firms could not be inferred. For instance, the Board should not make reference to a firm’s location and/or size of practice, as this information may cause a reader to infer the identity of the firm.

CONCLUSION

We acknowledge the enormous effort put forth by the members and staff of the PCAOB to implement the provisions of the Act. Inspections of registered public accounting firms are critical to the Board's mission to oversee the audits of public companies. We appreciate the opportunity to provide comments concerning the Board's proposed rules on inspections of registered public accounting firms. We are firmly committed to working with the PCAOB in accomplishing the timely and effective implementation of the Act, including that of inspections, and would welcome the opportunity to meet with you to clarify any of our recommendations.

Sincerely,

A handwritten signature in black ink, appearing to read "Robert J. Kueppers". The signature is fluid and cursive, with a long horizontal flourish extending to the right.

Robert J. Kueppers
Chair
SEC Practice Section Executive Committee