

**AMERICAN BAR ASSOCIATION**  
**Section of Business Law**  
750 North Lake Shore Drive  
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August 21, 2003

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:

This letter is submitted on behalf of the Committees on Law and Accounting and Federal Regulation of Securities of the American Bar Association's Section of Business Law (the "Committees") in response to the request by the Public Company Accounting Oversight Board (the "Board") for written comments on its proposed rules on inspections of registered public accounting firms (the "Proposal"). The Board issued the Proposal in response to §104 of the Sarbanes-Oxley Act of 2002 (the "Act"), which directs the Board to conduct a continuing program of inspections to assess the degree of compliance of each public accounting firm registered with the Board, and that firm's associated persons, with the Act, the rules of the Board, the rules of the Securities and Exchange Commission (the "Commission"), and professional standards in connection with the performance of audits, the issuance of audit reports, and related matters involving U.S. public companies.

The comments expressed in this letter represent the views of the Committees only and have not been approved by the American Bar Association's House of Delegates or Board of Governors and therefore do not represent the official position of the Association. In addition, this letter does not represent the official position of the ABA Section of Business Law, nor does it necessarily reflect the views of all members of the Committees.

Various members of our Committees represent public accounting firms, and some members represented clients in connection with the legislative activity that led to the Act. In preparing this comment letter, we have directed our comments to issues on which we have professional expertise.

## **I. General Comments**

Section 104 of the Act directs the Board to conduct a continuing program of inspections to assess the degree of compliance of each registered public accounting firm and associated persons of that firm with the Act, the rules of the Board, the rules of the Commission, and professional standards in connection with the performance of audits, the issuance of audit reports, and related matters involving U.S. public companies. Within this framework, the Board has considerable discretion in establishing the procedures and requirements for the inspection program.

The Committees support the establishment of an inspection program and believe that the Board's inspection program should be designed to ensure that registered public accounting firms that audit SEC-registered issuers are in compliance with all applicable U.S. laws and professional standards. At the same time, the Committees believe that the Board should provide additional guidance on certain aspects of the Proposal to minimize potential confusion regarding certain aspects of the new inspection program.

We set forth below our comments with respect to specific aspects of the Board's proposed inspection program.

## **II. Specific Observations**

### **A. Proposed Rule 4000: General**

Under proposed Rule 4000, the Board apparently could authorize persons other than the staff of the Board's Division of Registration and Inspections to perform inspections on behalf of the Board.

While the Committees believe that it may be appropriate and necessary for the Board to engage "other persons" to undertake inspections in certain situations, the standards for engaging such persons under the proposed rule is quite open-ended. For example, Proposed Rule 4000 is silent with respect to whether the Board has established adequate procedures to ensure that any such "other persons" engaged by the Board would not disclose confidential and proprietary information about a firm made known to such individuals during an inspection. Insofar as the consequences to an inspected firm could be quite significant if sensitive information were to be inadvertently or deliberately disclosed by such other persons, the Committees recommend that the rules expressly establish (1) who may qualify to be an "other person" authorized to perform inspections on behalf of the Board, (2) the circumstances in which the Board may engage such "other persons," and (3) what steps the Board would take to ensure that such persons would be subject to appropriate oversight and supervision by the Board.

### **B. Proposed Rule 4002: Special Inspections**

The Proposal authorizes the Board to perform both "regular" and "special" inspections. Under proposed Rule 4002, "special inspections" would be performed "as are

necessary and appropriate concerning an issue or issues specified by the Board in connection with its authorization of the special inspection.” The Committees believe that the concept of a “special inspection” requires clarification, because it may prove difficult to distinguish between a “special inspection” under this Proposal and an “informal inquiry” under the Board’s separate proposals relating to investigations and adjudications (PCAOB Rulemaking Docket Matter No. 005).

As we understand the Board’s proposal, the purpose of an inspection – whether regular or special – is to assess firm-wide or systemic quality controls or compliance with applicable laws and professional standards. The Proposal should clarify that the purpose of an inspection is not to conduct an informal inquiry on behalf of the Board’s Division of Enforcement and Investigation, as we believe that this would blur the distinctions between the responsibilities of the Division of Registration and Inspections and the Division of Enforcement and Investigation. Moreover, such “mission creep” would create a risk that some of the procedural protections afforded for registered public accounting firms and their associated persons under the Board’s separate rules on investigations and adjudications will not be available. Consistent with that goal, we also recommend that the Board’s staff provide notice if there is an informal or formal investigation underway at the time of an examination. In our experience, this is the typical practice followed by the SEC’s Office of Compliance Inspections and Examinations (“OCIE”).

Accordingly, while the Committees believe that the concept of a special inspection is appropriate, and that the various divisions of the Board should coordinate their activities to avoid duplicative work, we urge the Board to provide additional guidance on the purpose and scope of a special inspection.

C. Proposed Rule 4004: Procedure Regarding Possible Violations

Section 104(c)(2) of the Act states that the Board may make referrals of information relating to potential violations uncovered during an inspection to the Commission and to “each appropriate State regulatory authority.” Proposed Rule 4004, however, suggests that Section 104(c)(2) does not limit the Board’s authority to refer such information to other authorities not mentioned in the statute.

It appears to the Committees that Section 104(c) does limit the bodies to which information developed during an inspection could be referred, so it is unclear why the Board has concluded that such broader referrals are permissible under the Act. The Committees are concerned that extending referrals under §104 of the Act to other entities (for example, those identified under Section 105(b)(5)(B) of the Act) would blur the distinction between Board inspections and investigations. Accordingly, we recommend that the proposed Rule 4004 expressly limit referrals of information relating to potential violations uncovered during an inspection to the Commission and to each appropriate state regulatory authorities as set forth under §104(c).

D. Proposed Rule 4006: Duty to Cooperate With Inspectors

Under proposed Rule 4006, every registered public accounting firm, and every associated person of a registered accounting firm, must provide “access to, and the ability to copy, any record in the possession, custody, or control of such firm or person and providing, by oral interview, written response, or otherwise, such other information as may be requested by the Board’s inspectors and that the Board considers relevant or material to the subject matter of the inspection.”

While the Committees recognize that the duty to cooperate with inspectors is critical to the Board’s inspection program, the proposed language that the Board may request “*any* record in the possession, custody, or control” of a registered public accounting firm or any every associated person “that the Board considers relevant or material to the subject matter of the inspection” is an overly broad and subjective standard. Accordingly, we urge the Board to clarify, consistent with the standard established under Section 104(a) of the Act, that materials “relevant or material” to the subject matter of an inspection would, by definition, specifically relate to a registered public accounting firm’s compliance with the Act, Board or SEC rules, or applicable professional standards relating to the firm’s performance of audits, issuance of audit reports, or related matters involving issuers.

E. Proposed Rule 4007: Procedures for Firm Review and Response to Draft Inspection Report and Issuance of Final Inspection Report

While Proposed Rule 4007 contemplates that a registered public accounting firm may review and comment on a draft inspection report before the Board issues a final written inspection report, it does specifically provide for or require an exit interview following an inspection (special or regular) and prior to the issuance of a draft report. In our experience, the SEC’s OCIE generally provides for such interviews following examinations of registered broker-dealers and investment advisers.

F. Proposed Rule 4008: Transmittal of Final Inspection Report

Under Proposed Rule 4008, the Board must transmit a copy of a final inspection report to the Commission, the various state regulatory authorities, and the accounting firm that is the subject of the report. The proposal further contemplates that the inspection report, when sent to the Commission or a state regulatory authority, may be accompanied by “any additional letter or comments by the Board or the Board’s inspector that the Board deems appropriate.” While Section 104(g) allows the Board to provide inspection reports to such authorities accompanied by transmittal letters, the proposal, as drafted, is troubling. In particular, it raises the concern that the Board might routinely send detailed “side letters” to the Commission or state regulatory authorities at the end of an inspection relaying observations or other information that was not shared with the inspected firm. Conceivably, under the proposal, the Board could determine that an inspected firm had a systemic or firm-wide problem and notify the Commission and state regulators of the issue without ever having brought it to the attention of the firm or solicited its views or ability to adopt appropriate remedial measures.

In our view, this prospect would be inconsistent with the intent of Section 104(f) of the Act, as well as Proposed Rule 4007, each of which contemplates that a registered public

accounting firm should have an opportunity to review and respond to the Board's proposed inspection findings. While the Committees support the Board's authority to provide relevant information to appropriate regulatory authorities, we urge the Board to share any additional letter or comments with the inspected firm, as well as to provide such firm with the opportunity to respond to the findings in such additional letter or comments. In our view, transparency and openness between the Board and the accounting firms throughout the inspection process will best achieve the goals contemplated by Congress under the Act.

G. Issues Affecting Foreign Accounting Firms

Firms located outside the United States may face unique challenges in complying with the Board's inspection requirements, particularly where they conflict with obligations or restrictions imposed on the firms under the laws of foreign jurisdictions. The Board's proposal indicates that the Board is sensitive to such considerations and is committed to finding ways to accomplish the Act's goals without subjecting non-U.S. firms to "unnecessary burdens or conflicting requirements." In addition, the Board has announced that the nature and scope of the Board's oversight over non-U.S. accounting firms that audit the financial statements of U.S. public companies will be the subject of dialogue between the Board and its foreign counterparts. We support the Board's efforts to coordinate its activities with those of its counterparts outside the United States.

In this regard, we suggest that one issue merits clarification. The unique challenges that non-U.S. firms may confront under the Board's requirements could arise regardless of whether the non-U.S. firm was itself the subject of a Board inspection or was instead an "associated person" of another firm (for example, a U.S. firm) that was the principal subject of the inspection. Specifically, under Proposed Rule 4006, "[e]very registered public accounting firm, *and every associated person* of a registered public accounting firm, shall cooperate with the Board in the performance of any Board inspection" (emphasis added). Accordingly, the Board should make clear that it will be sensitive to the potential impact of its rules on non-U.S. firms in any context where a non-U.S. firm is asked to provide information in connection with a Board inspection that may subject the non-U.S. firm to duplicative oversight or conflicting legal obligations.

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We appreciate the Board's consideration of the Committees' comments. Members of the Committees would be pleased to meet with representatives of the Board to discuss our comments.

Respectfully submitted,

/s/ Thomas L. Riesenber

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