April 3, 2006

Ms. Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: SEC Release No. 34-53247: PCAOB; Notice of Filing of Proposed Ethics and Independence Rules Concerning Independence, Tax Services and Contingent Fees

Members and Staff of the Commission:

The American Institute of Certified Public Accountants (AICPA) respectfully submits the following written comments on the U.S. Securities and Exchange Commission's (SEC or the Commission) release of the proposed rules that the Public Company Accounting Oversight Board (PCAOB or the Board) has filed with the Commission, *Proposed Ethics and Independence Rules Concerning Independence, Tax Services and Contingent Fees* (the Release).

The AICPA is the largest professional association of certified public accountants in the United States, with more than 340,000 members in business, industry, public practice, government and education. The comments in this letter represent the views of those members who audit public companies. Due to the subject matter of the Release, significant input has been received from the Professional Ethics Executive Committee and the Tax Executive Committee of the AICPA.

The AICPA recognizes the enormous effort made by the members and staff of the PCAOB and SEC to implement the provisions of the Sarbanes-Oxley Act of 2002 (the Sarbanes-Oxley Act or the Act). As part of that effort, the Board has submitted rules to the SEC to promote the ethics and independence of registered public accounting firms that audit and review financial statements of U.S. public companies. The AICPA appreciates the opportunity to comment on the Release.

We are supportive of the Commission's and the Board's efforts to strengthen the profession's ethics and independence rules as they relate to financial statement audits of public companies. Throughout its history the AICPA has been deeply committed to auditor independence. It is a core tenet of the accounting profession, which has a more than 100-year history of working to uphold auditor independence.

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Overall, we believe the Board has taken a reasonable approach in addressing and differentiating between the types of tax services and transactions that pose an unacceptable threat to the auditor independence from those that do not. We also commend the Board for recognizing that there are many types of tax services that the firm could perform for an audit client that do not impair the auditor's independence. By virtue of the independent auditor's understanding of the financial activities of an audit client, auditors have been the logical professionals on whom audit clients rely for tax reporting to governmental authorities as well as for advice on the tax effects of alternative business decisions. Audit quality is enhanced when auditors obtain a deeper understanding of a client's financial transactions as a result of providing permitted tax services.

However, we have identified a number of issues that we believe require further consideration or clarification. Accordingly, we offer the following comments, observations and recommendations regarding the Release as discussed below.

We believe that, in certain instances, the Commission needs to either revise the rules or provide additional guidance (e.g., through separate commentary, FAQ's, etc.) to clarify the rules in order to allow for the proper implementation by firms and public company clients.

Proposed Rule 3502 – Responsibility Not to Knowingly or Recklessly Contribute to Violations

Proposed Rule 3502 would sanction individual accountants for "contributing" to violations of the Act, the rules of the Board, certain provisions of the federal securities laws, or professional standards by a registered public accounting firm. The Board has acknowledged that this rule tracks language in Section 21C of the Securities Exchange Act of 1934 (the "Exchange Act"). While the PCAOB has characterized Rule 3502 as an "ethical standard" adopted pursuant to Section 103(a) of the Act, the Act does not expressly authorize the PCAOB to impose "secondary liability" on individual accountants, and the AICPA questions whether Rule 3502 is an appropriate exercise of the Board's rulemaking authority. In addition, to address the SEC Staff's concern that the rule's adoption could create confusion as to the standards for liability under Section 21C, the Board adopted a "technical amendment" to Rule 3502 in November 2005, but the amended Rule 3502 appears to raise the same issues relating to Section 21C as the version of the rule adopted in July 2005. We have elaborated on these observations for the SEC's consideration in Appendix A.

Proposed Rule 3522 – Tax Transactions

Notwithstanding the numerous layers of statutory, regulatory, and ethical safeguards that already apply to the provision of tax services by CPAs, the AICPA believes it is entirely appropriate to promulgate prohibitions with regard to those services that "pose special challenges" to independence. However, we believe, that to provide more certainty to the application of the rules, a number of issues require additional elaboration.

We appreciate the changes made in the final rules regarding independence impairment when "opining **in favor** of the tax treatment" (emphasis added) but believe the term "planning" needs some clarification along similar lines. Presumably, the issue with "planning" relates to situations where the auditor has also recommended the transaction to an audit client, or where the auditor positively opines on such a transaction and the transaction is implemented. There are a number of situations where the auditor may be considered to be involved in "planning" but that activity would not negatively impact independence. For example, (a) the firm recommends a transaction and before the engagement is finalized, the transaction becomes listed and the firm withdraws its recommendation of the transaction; (b) the firm recommends a transaction and before the engagement is finalized, the firm realizes the transaction may be substantially similar to a listed transaction and the firm withdraws its recommendation of the transaction; or (c) the firm is asked by its audit client to opine on a transaction, the firm believes the transaction does not meet the "more likely than not" standard, which is communicated to the client. Since the three examples are situations where the auditor has **not** opined in favor of the tax treatment, but rather are clearly permitted "planning" activities[1], we recommend that the term "planning" be eliminated or, alternatively, the regulations should clarify that these situations would not impair independence by distinguishing between permitted and prohibited "planning" activities.

Response to SEC Questions in Release Regarding Tax Transactions

The Commission has requested comment on whether additional guidance is necessary regarding the consideration of an auditor's independence when a transaction planned or opined on by the auditor subsequently becomes listed. Specifically, the Commission asks whether it is clear from the Board's discussion that a subsequent listing of a transaction, while not in and of itself impairing the auditor's independence prior to the listing of the transaction, may impact independence from the date of the listing forward.

The Proposing Release indicates that, "*Proposed Rule 3522 is intended to describe a class of tax-motivated transactions that present an unacceptable risk of impairing an auditor's independence...*". From an ethics perspective, we believe a transgression can only take place where an auditor knows, or should have known, a rule is being violated. From a fairness perspective, we believe the proposed rule may be unworkable unless the timing of the independence impairment is fixed at the time the transaction is executed. Retroactively challenging the auditor's independence during "the audit and professional engagement period," and certainly beyond that period, would cause irreparable harm to the audit client. Conversely, there have been recent situations where courts have found in the taxpayer's favor regarding listed transactions challenged by the IRS, or the IRS has included and subsequently removed a transaction from its list. Nevertheless, if at the time the transaction was executed, it was a listed transaction, an independence impairment is appropriate as both parties were on notice.

[1] SEC Release No. 34—53427, page 31: ". . . the Board has modified the rule to make clear the prohibition on opining on aggressive transactions is limited to 'opining in favor of the tax treatment of' such transactions . . ."

The Department of the Treasury recognized the need for certainty in timing when it promulgated final regulations (REG-122379-02) revising the regulations governing practice before the Internal Revenue Service (Circular 230). § 10.35 indicates that a practitioner who provides written advice regarding certain transactions ("covered opinions") must comply with a specific list of requirements relating to the development of the opinion (§ 10.35(c)). The first item described as a "covered opinion" indicates, "A transaction that is the same as or substantially similar to a transaction that, *at the time the advice is rendered* (emphasis added), the Internal Revenue Service has determined to be a tax avoidance transaction and identified by published guidance as a listed transaction under 26 CFR 1.6011-4(b)(2)."

Accordingly, we recommend that the adopting release make it clear that provided the auditor did not know, or should not have known, that a transaction would become listed, independence would not be considered impaired if a transaction planned or opined on by the auditor subsequently becomes listed.

Proposed Rule 3523 – Tax Services for Persons in Financial Reporting Oversight Roles

As discussed in our February 14, 2005 comment letter to the PCAOB, from a conceptual level, we do not believe that the performance of routine tax return preparation and compliance services or general tax planning and advice for these individuals result in a threat to the auditor's independence. The Release states that, "The Board continues to believe that the provision of tax services by the auditor to the senior management individuals responsible for the audit client's financial reporting creates an unacceptable appearance of the auditor and such senior management having a mutual interest." Conceptually, we do not see how the performance of certain types of tax services that the Board has proposed to *permit* for the audit client itself (e.g., tax compliance services) would create a mutuality of interests when performed for individuals in a financial reporting oversight role at the audit client. Please refer to the AICPA's comment letter to the PCAOB in response to the proposed rulemaking for further discussion of this matter.

We note that the Board has included an exception in Rule 3523(b) whereby the auditor is not restricted from providing tax services to employees in a financial reporting oversight role at an *affiliate of an audit client*, provided the financial statements of the affiliate are not material to the financial statements of the audit client or are audited by an auditor other than the firm or an associated person of the firm. While we agree that such an exception is appropriate, we believe clarification is necessary because the Release refers to a *subsidiary* of an audit client whereas the proposed rule refers to an *affiliate* of the client. The term "affiliate of the audit client" is defined in the proposed rule whereas the term "subsidiary" is not. Accordingly, we recommend that the Board revise this discussion to delete reference to "subsidiary" and replace the term with "affiliate."

Finally, while we support the Board's inclusion of an exception to the rule that applies to a person who was not in a financial reporting oversight role at the audit client before a hiring, promotion, or other change in employment event, we believe that transitional relief is also needed for

situations where a nonpublic company client becomes public during the year, due to an initial public offering, merger or acquisition, etc. As drafted, the proposed rule would consider the auditor's independence to be impaired in such cases if the auditor provided tax services to a person in a financial reporting oversight role during the period. We therefore believe that the Board's final rule should clarify that the firm's independence would not be impaired if during the period tax services were provided to an individual in a financial reporting oversight role at a nonpublic company client which subsequently becomes a public company through an acquisition, merger or by other means, provided such tax services are completed in a reasonable time period.

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We appreciate the opportunity to comment on the Release. We are firmly committed the development of fair and effective ethics and independence rules. We would welcome the opportunity to meet with you to clarify any of our recommendations.

Sincerely,

Susan S. Coffey, CPA
Senior Vice President
AICPA

cc: Chairman Christopher Cox
Commissioner Cynthia A Glassman
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Commissioner Roel C. Campos
Commissioner Annette L. Nazareth
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Willis D. Gradison, Acting Chairman of the PCAOB
Kayla J. Gillan, Member
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APPENDIX A

Supplemental Comments on Proposed Rule 3502: Responsibility Not to Knowingly or Recklessly Contribute to Violations

The AICPA supports the PCAOB's efforts to enforce legal requirements and professional standards that apply to individual accountants and believes that the PCAOB can – and should – hold accountable individual accountants who have violated their professional obligations. Indeed, the PCAOB has already adopted several rules that make clear that many Board requirements apply directly to "associated persons" of registered public accounting firms, and the AICPA believes that the PCAOB should continue to adopt such rules in the future, when warranted in particular circumstances.

As discussed below, however, Proposed Rule 3502 would establish a new basis for the PCAOB to impose "secondary liability" on individual accountants for "contributing" to violations of the Act, the rules of the Board, certain provisions of the federal securities laws, or professional standards. While the Board stated in July 2005 that Rule 3502 is an "ethical standard" adopted pursuant to the PCAOB's rulemaking authority under Section 103(a) of the Act, the AICPA questions whether the Board's authority can be read so broadly to authorize the creation of a new basis, found nowhere in the Act, for imposing "secondary liability" on individual accountants for "causing" a firm's violation. Moreover, the adoption of a new rule imposing liability on accountants who "contribute" to violations by accounting firms would result in unnecessary confusion as to the applicable standards for liability under both Rule 3502 and Section 21C of the Securities Exchange Act of 1934 (the "Exchange Act"), which authorizes the SEC to order any person who has "caused" a violation of the federal securities laws to cease and desist from such conduct. We set forth our concerns in this regard below for the SEC's consideration.

The Board's Authority to Impose Secondary Liability on "Associated Persons"

The Sarbanes-Oxley Act clearly empowers the PCAOB to investigate and bring disciplinary actions against registered public accounting firms and their associated persons for violations of the Act, the rules of the Board, the provisions of the federal securities laws relating to the preparation and issuance of audit reports, or professional standards. This authority is embodied in numerous provisions of the Act, including Sections 101(c)(4), 105(a), 105(b)(1), and 105(c)(4). Accordingly, the PCAOB has adopted a series of rules clarifying that associated persons of registered public accounting firms are required to comply with applicable professional standards. In particular:

- Board Rule 3100 provides that associated persons of a registered public accounting firm "shall comply with all applicable auditing and related professional practice standards";

- The Board's current interim auditing, attestation, quality control, ethics and independence standards (Rules 3200T, 3300T, 3400T, 3500T and 3600T) all require compliance with such standards by associated persons of a registered public accounting firm; and

- Board Rule 1001(a)(xii) defines the term "auditor," for purposes of the PCAOB's rules generally, to include associated persons as well as the registered public accounting firms with which they are associated.

The AICPA supports the PCAOB's adoption of these rules, as well as the Board's obligation under the Act to impose appropriate sanctions on associated persons of registered public accounting firms who have violated applicable standards. In light of the PCAOB's current authority and existing rules, however, it is unclear what purpose would be served by adopting an additional rule that would create a new general standard of secondary liability for individual accountants who have "contributed" to a firm's violation of the Act, the Board's rules, various provisions of the federal securities laws or professional standards.

In adopting Rule 3502 in July 2005, the PCAOB stated that the rule represented a reasonable exercise of the Board's authority under Section 103(a) of the Act to establish "ethics standards to be used by registered public accounting firms in the preparation and issuance of audit reports * * * or as may be necessary or appropriate in the public interest or for the protection of investors."[2] Rule 3502 does not, however, address or provide specific guidance to firms with respect to a particular area of professional ethics, as do the "Interim Ethics Standards" previously adopted by the Board in Rule 3500T. Instead, the rule would impose secondary liability on an associated person of a registered public accounting firm in a broad range of circumstances where he or she might be said to have "contributed" to a registered firm's violation. Indeed, in many instances, the firm's violation might be wholly unrelated to its "preparation and issuance of audit reports" for a particular audit client (as might be the case, for example, with certain violations of quality control standards). If the PCAOB's authority to establish "ethics standards" under Rule 103(a) were truly as broad as suggested by the Board in adopting Rule 3502, there would appear to be no boundaries that the PCAOB would recognize with respect to the scope of its authority. Accordingly, the AICPA questions whether Rule 3502 reflects an appropriate exercise of the Board's rulemaking authority under Section 103(a) of the Act.

Moreover, the AICPA does not believe that the Act permits the PCAOB to expand the scope of an associated person's liability through such a general rule. In this regard, the concept of secondary liability was not discussed in, or apparently contemplated by, the Act. The determination of congressional intent with respect to the scope of liability created by a particular statute rests primarily on the language of that statute.[3] In *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, the Supreme Court held that there was no private right of action for "aiding and abetting" primary violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, because the text of the Exchange Act could not be read to reach persons who aid and abet Section 10(b) violations.[4] Recognizing that the Court's rationale would apply

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2 *See* Public Company Accounting Oversight Board; Notice of Filing of Proposed Ethics and Independence Rules Concerning Independence, Tax Services, and Contingent Fees, 71 FED. REG. 12720, 12723 (Mar. 13, 2006).

3 *See Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 175 (1994) (citing *Pinter v. Dahl*, 486 U.S. 622, 653 (1988)).

4 *Id.* at 177.

equally to aiding and abetting actions brought by the SEC itself, the SEC thereafter requested and received express statutory authority from Congress to bring charges against those who aid and abet other persons' violations of the Exchange Act.[5]

Proposed Rule 3502 is modeled not on the concept of "aiding and abetting" liability, but instead on another theory of secondary liability expressly provided for under Section 21C of the Exchange Act. Section 21C permits the SEC to institute cease-and-desist proceedings against any person who violates the Exchange Act and any other person who is a "cause" of the violation, "due to an act or omission the person knew or should have known would contribute to such violation." Thus, the SEC's authority to bring a proceeding against a person for contributing to another person's violation of a statutory or regulatory requirement is expressly authorized by statute.

In comparison, no provision of the Act authorizes the imposition of secondary liability on associated persons of registered public accounting firms generally, nor does any provision specifically contemplate the imposition of liability on such persons for contributing to violations by firms. In its July 2005 release, the PCAOB suggested that the *Central Bank* decision and the SEC's subsequent decision to seek legislative authority under the Exchange Act were irrelevant to its adoption of Rule 3502, in light of the Board's authority to establish ethics standards under Section 103(a) of the Act.[6] At the time of the *Central Bank* decision in 1994, however, the SEC possessed rulemaking authority under Section 23(a)(1) of the Exchange Act that was certainly as broad, if not broader, than the Board's authority under Section 103(a) of the Act.[7] Nevertheless, the SEC appropriately sought express authority from Congress to impose secondary liability on persons for "causing" other persons' violations, rather than circumvent the intent of Congress by unilaterally adopting a rule purporting to create such liability. The AICPA respectfully submits that the SEC should be equally mindful here of the limitations imposed by Congress on the scope of the PCAOB's authority.

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5 *See id*. at 200 ("The majority leaves little doubt that the Exchange Act does not even permit the SEC to pursue aiders and abettors in civil enforcement actions under § 10)b) and Rule 10b-5.") (Stevens, J.., dissenting); Testimony of Arthur Levitt, Chairman, United States Securities and Exchange Commission Concerning Litigation Reform Proposals Before the Subcommittee on Telecommunications and Finance, Committee on Commerce, United States House of Representatives (Feb. 10, 1995), *available at* http://www.sec.gov/news/testimony/testarchive/1995/spch025.txt. *See also* Section 20(e) of the Exchange Act.

6 71 FED. REG. at 12723.

7 Section 23(a)(1) authorizes the SEC to make such rules and regulations "as may be necessary or appropriate to implement the provisions of [the Exchange Act] * * * or for the execution of the functions vested" in the SEC by the Exchange Act.

The Standards for Liability under Rule 3502 Are Confusing

Rule 3502, as adopted by the PCAOB in July 2005 and subsequently amended in November 2005, differs in various respects from the rule as originally proposed by the PCAOB in December 2004. In particular, the original rule expressly referred to conduct by an associated person that "causes" a violation by a registered public accounting firm, whereas the current version eliminates any reference to "causing" violations and refers instead to conduct that "directly and substantially contributes" to a violation. The AICPA understands that the PCAOB eliminated the reference to "causing" violations in November 2005 based on the SEC's concern that, if Rule 3502 were adopted in its then-current form, confusion likely would arise as to the standards for liability under Section 21C of the Exchange Act.[8]

Notwithstanding the PCAOB's efforts to clarify and limit the scope of Rule 3502, the AICPA believes that the current rule remains ambiguous in key respects. For example, on its face, the rule purports to be limited to conduct by an associated person of a registered public accounting firm that "directly and substantially contributes" to a violation by the firm. The PCAOB has stated, however, that conduct will be deemed to "directly" contribute to a violation if it "is a reasonably proximate facilitating event of, or a reasonably proximate stimulus for, the violation."[9] The PCAOB has provided no further guidance or examples as to what might constitute "reasonable proximity" to a firm violation for such purposes, and it appears entirely possible, if not likely, that the PCAOB would apply the rule in a far broader range of circumstances than the language of the rule itself would suggest to practitioners.

Moreover, the AICPA believes that the rule, if adopted, would result in confusion as to the applicable standards for liability under both Rule 3502 and Section 21C of the Exchange Act. Despite the PCAOB's "technical amendment" to Rule 3502 in November 2005, which eliminated any express references to imposing liability on associated persons for "causing" violations by registered firms, Rule 3502 remains patterned after Section 21C of the Exchange Act, as the PCAOB has acknowledged.[10] As a result, and notwithstanding other textual distinctions that may exist between Rule 3502 and Section 21C, future cases decided under Rule 3502 might affect the interpretation by courts of Section 21C, and *vice versa*, with respect to key issues such as: (1) whether the SEC (or PCAOB) must make a specific finding that a primary

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8 71 FED. REG. at 12735 (noting that the Board had adopted "technical amendments" to Rule 3502 "[a]fter discussions with the SEC staff"). In addition, the rule as originally proposed would have covered negligent conduct by an associated person of a registered public accounting firm, whereas the current version of the rule purports to prohibit knowing or reckless conduct.

9 *Id* at 12724.

10 *Id.* at 12724 n. 9 (stating that "the Board's proposed rule tracked some of the language of Section 21C" of the Exchange Act). The PCAOB has also stated that the rule, as amended in November 2005, "should be interpreted and understood to be the same as the rule adopted by the Board" in July 2005, which expressly imposed liability on associated persons for "causing" violations. *Id.* at 12735. Accordingly, the November 2005 amendment to Rule 3502 actually serves to *increase*, rather than *decrease*, the potential confusion regarding the rule's background and future interpretation, since the rule clearly was – and remains – designed to impose secondary liability on persons who have "caused" violations by registered public accounting firms.

violation has occurred prior to imposing a sanction on a third party (or an associated person) for "causing" (or "directly and substantially contributing") to the violation; and (2) the precise state of mind which the SEC or PCAOB must establish to support a proceeding under Section 21C or alleging a violation of Rule 3502. The AICPA believes that the SEC should consider these risks to its broader enforcement program in evaluating Rule 3502, particularly since, as discussed below, the PCAOB has alternative, more targeted means to achieve its goals of promoting auditor independence.

Alternative Means to Achieve the PCAOB's Regulatory Goals

The PCAOB has stated that Rule 3502, which the Board proposed as part of a broader set of independence requirements, "is essential to the functioning of the Board's independence rules."[11] The AICPA submits, however, that there are other, more targeted means available to the Board that would make clear that associated persons of a registered public accounting firm are expected to comply with the Board's independence standards, without raising the concerns posed by Rule 3502. In particular, the Board could provide that its independence rules apply to "auditors," which PCAOB Rule 1001(a)(xii) defines to include both registered public accounting firms *and* their associated persons. This approach would be consistent with the SEC's independence rules, which apply to "accountants" (a term defined in Rule 2-01(f)(1) of Regulation S-X to include both registered public accounting firms and individual accountants). The SEC's approach has worked well for many years, and the AICPA sees no reason why the SEC could not direct the PCAOB to follow a similar approach in its independence requirements.

11 *Id.* at 12724.