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May 14, 2004

Jonathan G. Katz
Office of the Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, D.C. 20549-0609

Re: File No. PCAOB-2003-08

PCAOB Proposed Rules on Inspections

Dear Mr. Katz:

Deloitte & Touche LLP is pleased to respond to the request for comments from the Securities and Exchange Commission (the "SEC" or the "Commission") on the *Proposed Rules on Inspections*, filed by the Public Company Accounting Oversight Board (the "PCAOB" or the "Board") for the Commission's approval. *See Public Company Accounting Oversight Board; Notice of Filing of Proposed Rule and Form Relating to Inspections of Registered Public Accounting Firms*, 69 Fed. Reg. 22103 (Apr. 23, 2004) (hereinafter "Notice").[1] We support the

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[1] The PCAOB also issued a release of its final proposed rules on October 7, 2003, containing more detailed explanations of the reasons behind its proposed rules and of its responses to the concerns of commenters. *See Inspection of Registered Public Accounting Firms*, PCAOB Release No. 2003-019 (Oct. 7, 2003) (hereinafter "Release"). The Notice states that it includes only the Board's "summaries of the most significant aspects" of the Release and directs commenters to the Release for more detailed explanations. Notice, 69 Fed. Reg. at

[Footnote continued on next page]

goals of the Sarbanes-Oxley Act of 2002 (the "Act") in restoring investor confidence, as well as the Board's efforts, under the review of the Commission, to develop rules that implement the Act faithfully.

INTRODUCTION

On July 28, 2003, the Board proposed rules to govern its inspections under Section 104 of the Act. We provided comments to the Board on its proposal and identified modifications and clarifications of the proposed rules necessary to make the Board's final rules workable and consistent with Congress's mandate under Section 104.[2] In its revised release, the Board made some progress in this regard. However, we continue to believe that critical aspects of the Board's rules submitted to the Commission need to be modified in order to facilitate an effective, balanced, and fair inspections process. The issues discussed in this letter represent our most important concerns with the proposed rules. For the reasons set forth below, we recommend that the Commission either make significant changes to the proposed rules or remand the rules to the PCAOB with specific instructions to address these priority issues.

The Commission has a special responsibility with regard to its review of the Board's rules. Congress established the Board as a private "nonprofit corporation."[3] The Board's rules, however, must be approved by the Commission, which is a government agency and which,

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22105. Accordingly, we rely on both the Release and the Notice as the Board's explanation for its proposed rules.

[2] Deloitte & Touche, *Comment on PCAOB Docket Matter No. 006, Proposed Rules on Inspections of Registered Public Accounting Firms* (Aug. 19, 2003) (hereinafter "D&T Comment").

[3] Act § 101(b).

therefore, must act in accordance with the Constitution, the Administrative Procedure Act, and other federal statutes governing agency action. Moreover, under the Act, the Commission has the authority to review final reports of the Board's findings relating to inspections in certain circumstances, and to review Board determinations that a firm has not satisfactorily addressed criticisms of or potential defects in its quality control systems.[4] Accordingly, the Commission's thorough and judicious review of the proposed rules is necessary to ensure that the Board's procedures are fair, balanced, and clear, and to enable the Commission to review the product of the Board's inspection program with confidence and in a manner consistent with its own constitutional and statutory obligations. To that end, we encourage the Commission to make certain that registered public accounting firms and associated persons are guaranteed appropriate protections in the Board inspection process.

In addition, we believe that the Commission should take sufficient time to address these concerns. According to the Notice, the Commission either will approve the rules only 14 days after comments are due or will announce that it will take up to another 55 days to review the rules.[5] We urge the Commission to avail itself of the longer review period to consider these issues.

Our comments below, as stated previously, represent only our most significant concerns with the proposed rules. Our initial comment letter contained many additional concerns, which we continue to believe are legitimate, but which are not as critical to the ultimate effectiveness of these rules. The issues articulated below address fundamental aspects of the proposed inspections

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[4] *Id*. § 104(h).

[5] Notice, 69 Fed. Reg. at 22109; *see also* Section 19(b)(2) of the Securities Exchange Act of 1934.

rule that without modification will impact the effectiveness of the Board's inspection process and undermine the mission of the PCAOB.

I. PROPOSED RULE 4009: FIRM RESPONSE TO QUALITY CONTROL DEFECTS

WHEN A FIRM HAS REQUESTED SEC REVIEW, CRITICISMS OF, OR POTENTIAL DEFECTS IN, A FIRM'S QUALITY CONTROL SYSTEMS SHOULD REMAIN CONFIDENTIAL UNTIL COMPLETION OF THE REVIEW PROCESS

The Board should not be able to publish criticisms of, or potential defects in, a firm's quality control systems when the firm has requested SEC review of a final Board determination that the firm has not addressed these criticisms or defects to the Board's satisfaction. As drafted, Proposed Rule 4009 requires the Board to make quality control information public 30 days after a firm requests SEC review unless the SEC directs otherwise.[6] Although this is longer than the 15-day period initially proposed by the Board,[7] we continue to believe, as stated in our comment letter to the Board, that to publish quality control information while the SEC's review is ongoing could cause irreparable harm to a firm, would be unfair and inequitable, and would not be in the public interest or consistent with the Board's mission.[8] Section 104(h)(1) of the Act provides for the Commission to promulgate rules governing the review process. Although the Commission has not yet proposed rules in this area, it is more than likely that the review process will take more than 30 days, and the SEC may well conclude following a review that a firm has adequately addressed any criticisms or potential defects in its quality control systems.

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[6] Proposed Rule 4009(d)(3).

[7] *See Proposed Rules on Inspections of Registered Public Accounting Firms*, PCAOB Release No. 2003-013, at A1-vi (July 28, 2003) (hereinafter "Initial Release") (discussing the Board's initial proposed Rule 4009(c)(3)).

[8] D&T Comment at 20.

Accordingly, the SEC should be allowed adequate time to conduct its review, and information about any criticisms of, or potential defects in, a firm's quality control systems should be kept confidential pending completion of the review.

We believe, as we stated in our comment letter to the Board, that the rule should state that the relevant portions of a report will *not* be made public until the *last* to occur of: (1) the expiration of the 12-month period after the issuance of a final inspection report (if a firm fails to respond to the report); (2) the expiration of the 30-day period during which a firm may seek SEC review of a final Board determination that the firm has not responded to potential quality control defects or criticisms identified by the Board;[9] or (3) for the reasons discussed in Section A, the conclusion of the SEC review process.[10] Revising the proposed rule in this way would correct the problem, and would make the language of the rule consistent with the emphasis on confidentiality embodied in Section 104(g)(2) of the Act, which states that "*no portions* of the inspection report that deal with criticisms of or potential defects in [a firm's] quality control systems . . . *shall be made public if*" the firm has addressed the criticisms or potential defects within 12 months after issuance of the report.[11] The underlying guarantee of confidentiality in Section 104(g)(2) (as reflected in the language quoted above) and in Section 105 of the Act weigh in favor of this result.

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[9] *See* Act § 104(h)(3).

[10] D&T Comment at 21-22.

[11] Act § 104(g)(2) (emphases added).

II. PROPOSED RULE 4004: PROCEDURE REGARDING POSSIBLE VIOLATIONS

A. THE RULE SHOULD LIMIT THE BOARD'S DISCRETION TO MAKE REFERRALS OF, OR TO REPORT INFORMATION REGARDING, POSSIBLE VIOLATIONS TO PARTIES BEYOND THOSE ENUMERATED IN THE ACT

Proposed Rule 4004 leaves the Board with sweeping authority to report information obtained during an inspection to the Commission and appropriate state regulatory authorities. A note to Proposed Rule 4004 provides that the Board may, as appropriate, make referrals or report information to regulatory and law enforcement agencies other than those specifically designated in the rule. According to the Board, the purpose of the note is "to provide notice that Rule 4004, in implementing Section 104(c) of the Act, should not be understood as precluding the Board from exercising the Board's other statutory authority to make referrals or to report information from inspections. Neither the rule nor the note are intended to describe the limit of that authority."[12]

The Board has taken the position that its authority to make referrals or to report information regarding possible violations of the Act, the Board's rules, statutes and rules administered by the Commission, a firm's quality control policies, and professional standards is not limited to the agencies specifically listed in Section 104(c) of the Act,[13] or even to the more expansive list of agencies identified in Section 105(b)(5)(B) of the Act.[14] We respectfully disagree. If the Board had such broad discretionary authority to disclose inspection-related information, there would have been no need for Congress to authorize the disclosure of such

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[12] Release at A2-11 to -12; Notice, 69 Fed. Reg. at 22106.

[13] Act § 104(c)(2) (providing that the Board "shall . . . report [possible violations] if appropriate, to the Commission and each appropriate State regulatory authority.").

[14] Release at A2-11 to -12.

information to the agencies specified in Section 104(c). Under the fundamental canon of statutory construction, *expressio unius est exclusio alterius*, the specification of certain parties to whom inspection-related information may be released in Section 104(c) signifies that the information may not be released to parties other than those listed.[15]

This system of limited disclosure is particularly important given the nature of the information covered by Proposed Rule 4004. Referrals or reports regarding possible violations will, by their very nature, be sensitive and could cause significant reputational and economic damage to a firm in the event of unauthorized disclosure. Accordingly, in the first instance, we believe that the agencies to which the Board may make referrals or report information regarding possible violations should be limited to those specified in Section 104(c) of the Act – specifically, the Commission and appropriate state regulatory authorities.

In the alternative, the agencies to which the Board can refer or report possible violations should be confined to those specifically identified in Section 105(b)(5)(B) of the Act. In the absence of such a limitation, the Board's sweeping assertion of authority eviscerates the confidentiality provisions of the Act. The Act makes clear that "all documents and information prepared or received by or specifically for the Board . . . in connection with an inspection" must remain confidential, except for disclosures to certain specified governmental agencies.[16] The Act's specification of a limited number of parties who may receive inspection-related information from the Board is part of the Act's delicate balance, to limit the scope of any

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[15] *See*, *e.g.*, *TRW, Inc. v. Andrews*, 534 U.S. 19, 28 (2001). The operation of this canon of construction is especially strong in conjunction with Section 105's guarantee of confidentiality. Courts have been particularly rigorous in holding that a list of specific exceptions to a general rule is exclusive.

[16] Act § 105(b)(5).

incursions into the statutory imperative of confidentiality that the Board's duties might seem to justify. The expansion of the Board's purported authority, as reflected in the note to Proposed Rule 4004, to make referrals or reports regarding possible violations to any party in the Board's discretion, displaces that careful judgment of Congress.

By permitting the Board to release inspection-related information to only a limited set of agencies, Congress was able to ensure that those agencies would keep the released information confidential. Specifically, Congress required that the specified agencies "maintain such information as confidential and privileged."[17] No provision of the Act directly addresses the confidentiality of information disclosed beyond the specific agencies enumerated in the Act. This is not surprising, as the Act did not contemplate such disclosures. Accordingly, Proposed Rule 4004's indiscriminate authorization for the Board's staff to make referrals or reports regarding possible violations in its discretion disrupts the confidentiality protections established by the Act.

At a minimum, the proposed rule's broad authorization of disclosures reinforces the need for the rule to provide that no information may ever be disclosed to any party in the absence of a confidentiality agreement. The Board states that it intends "to take reasonable measures to seek to ensure that the confidentiality requirements of the Act will be honored with respect to confidential information the Board reports to any regulatory or law enforcement authority."[18] But as noted above, because the Act does not contemplate disclosure to the agencies now covered by the note to Proposed Rule 4004, the Act does not speak directly to the confidentiality

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[17] *Id*. § 105(b)(5)(B)(ii)(IV).

[18] Release at A2-12 n.10.

obligations of those agencies. Thus, if the final rules were to allow staff discretion to make further disclosures, a confidentiality agreement, at the very least, would be necessary to fill the gap explicitly and to avoid an even more serious undermining of the structure of the Act than the proposed rule already would effect. Without such a revision, neither the Act nor the Board's proposed rules would expressly state these recipients' confidentiality obligations.[19] This outcome could not have been what Congress intended under Section 104(c) or Section 105(b)(5) of the Act.

B. The Proposed Rules Should Include Standards Governing When It Is Appropriate For The Board To Report Firms To The SEC And State Regulatory Authorities

In view of the scope of the Board's authority under Proposed Rule 4004, the Board has not adequately addressed concerns about its seemingly unfettered discretion to make referrals and to report information regarding possible violations, and we believe that the proposed rule should be revised to define the Board's discretion in this regard.

As we stated in our comment letter to the Board, we believe that there should be parameters governing the circumstances under which the Board may make referrals and reports.[20] Proposed Rule 4004 permits the Board, "if it determines appropriate," to make referrals or report information regarding possible violations to the Commission, appropriate state

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[19] To be sure, responsible regulators can be expected to respect the congressional command that inspection-related information be kept "confidential and privileged." Making that requirement explicit in the rules through the mandatory use of confidentiality agreements would ensure that recipients' obligations with respect to inspection-related information are clear from the outset, removing uncertainty and the need for costly litigation.

[20] D&T Comment at 9-11.

regulatory authorities, and other agencies.[21] This is a substantial reservation of discretion by the Board, particularly because the language of Proposed Rule 4004 permits reports and referrals upon any "indication" that there "may be" or "may have been" a violation of the Act, the Board's rules, statutes or rules administered by the Commission, a firm's quality control policies, or professional standards.

In response to comments that the "possible violation" threshold for triggering reports was too low, the Board has taken the position that it is constrained by the statutory mandate of Section 104(c) of the Act, which establishes this threshold.[22] Section 104(c) operates as a minimum standard for the Board's rulemaking; it does not, however, preclude the Board from articulating standards that specify when it is "appropriate" to make reports pursuant to Proposed Rule 4004. The only guidance the Board has offered in this regard are statements that it "will exercise judgment in determining when to make reports"[23] and that it "will decide which . . . acts, practices and omissions would be appropriate to refer to the Commission and to the states or other authorities" because it recognizes that the circumstances calling for reports will vary depending on the nature of the possible violation.[24] The Board's authority to report firms to regulatory authorities for a range of violations, both actual and potential, gives the Board enormous coercive power. In light of this, we believe that Proposed Rule 4004 should contain safeguards designed to protect against arbitrary action. In particular, the Board should be

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[21] *See* Act § 104(c)(2).

[22] Release at A2-10.

[23] *Id*. at A2-11.

[24] *Id.* at A2-9; Notice, 69 Fed. Reg. at 22106.

required to specify meaningful minimum criteria that would be applied in determining whether reports are appropriate. These criteria will promote consistent application of Proposed Rule 4004 and will minimize the risk that different outcomes will result – for example, situations where, in similar circumstances, the Board would report one firm but not another to the Commission or other authorities.

III. PROPOSED RULE 4006: DUTY TO COOPERATE WITH INSPECTORS

The vast expanse of information to which the Board would have access under Proposed Rule 4006 raises serious issues concerning constitutional protections, consistency with other laws and standards, and unnecessary burdens imposed on inspected firms.

A. THE PRODUCTION OF DOCUMENTS AND OTHER INFORMATION TO THE BOARD SHOULD BE REQUIRED ONLY TO THE EXTENT CONSISTENT WITH APPLICABLE LAWS AND PROFESSIONAL STANDARDS

The Board "intends to recognize certain privileges recognized elsewhere in the law – specifically, privileges that, under prevailing law, would constitute a valid basis for declining to comply with a Commission subpoena."[25] Importantly, however, the Board does not intend to honor assertions of accountant-client privilege.[26] Moreover, the Board has taken the position that any other perceived state-law or professional nondisclosure requirements or other obstacles to cooperation with an accounting board demand (other than privileges that would be a valid basis for resisting a Commission subpoena) are preempted by the Act.[27]

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[25] Notice, 69 Fed. Reg. at 22107; *see also* Release at A2-16.

[26] Release at A2-16; Notice, 69 Fed. Reg. at 22107.

[27] *Id*.

In our comment letter to the Board, we noted that the expansive language of Proposed Rule 4006 contained no safeguards to ensure that firms or their associated persons could assert any common-law or constitutional privileges, such as the attorney-client privilege or the work product doctrine, once confronted with an actual request from the Board under the rule.[28] We also noted that a requirement to provide client confidential information to a third party, including the Board, presents numerous potential conflicts with state laws and with non-U.S. laws and professional standards.[29]

Although the Board addressed some of these concerns, the Board did not go far enough. We believe that Proposed Rule 4006 should be amended to provide that the production of documents and other information covered by the rule is required only to the extent consistent with applicable laws and professional standards and that firms and their associated persons maintain their rights to assert any legally recognized grounds for objecting to a request for documents, interviews or other information. In the absence of such protections, the proposed rule would place firms and their associated persons in the untenable position of either refusing to comply with – and thereby possibly violating – Proposed Rule 4006, or providing client information to the Board and possibly violating state law, non-U.S. laws, or professional standards. The rule also should provide that, before firms or their associated persons are required to turn over information to the Board, they will have an opportunity to be heard with respect to any legal grounds they may have for not producing information to the Board. A mechanism that permits firms and their associated persons to explain the reasons for not

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[28] D&T Comment at 12.

[29] *Id*.

producing information to the Board is essential because, otherwise, the act of not producing information based on the assertion of a legitimate privilege or other valid protection could be viewed as a prima facie violation of Proposed Rule 4006.

B. The Board's Access To, And Ability To Copy, Accounting Firm Records, Should Be Subject To Reasonable Limitations

As a result of the comment process, the Board revised the language of Proposed Rule 4006, as it was initially proposed by the Board for comment, to afford the Board even broader access to documents and other information in the hands of registered public accounting firms. Specifically, the Board revised the rule to eliminate the requirement that information sought by the Board be "relevant or material to the subject matter of [an] inspection."[30] The Board replaced this limiting language with a requirement, based on the general cooperation standard in Section 102(b)(3) of the Act,[31] that firms comply with any request "made in furtherance of the Board's authority and responsibilities under the Act, to . . . provide access to . . . any record" in their possession or control and to provide "information."[32] Accordingly, Proposed Rule 4006 seemingly requires firms to provide the Board with access to and the ability to copy *any* record

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[30] Initial Release at A1-iv (Board's initial proposed Rule 4006). According to the Board, eliminating this restriction was warranted because "the documents and information the Board is likely to request as part of its authority and responsibilities to inspect registered public accounting firms, and that therefore a firm must cooperate by providing access to, will involve more than documents and information generated in the course of audits of issuers." Release at A2-14; Notice, 69 Fed. Reg. at 22106.

[31] Section 102(b)(3) requires each application for registration to include a consent executed by the accounting firm "to cooperation in and compliance with any request for testimony or the production of documents made by the Board in the furtherance of its authority and responsibilities under this title."

[32] Proposed Rule 4006.

in their possession, even if the record or information in question has no relevance to an inspection.

To safeguard against overly inclusive and potentially invasive requests for records and information, Proposed Rule 4006 should be revised to incorporate the proviso contained in the initial version of the rule regarding "relevan[ce] or material[ity] to the subject matter of the inspection." We believe this language strikes an appropriate balance by requiring that documents or other information requested by the Board bear a nexus to an inspection, regardless of whether the documents or information were generated in the course of an audit, but without going so far as to grant the Board overbroad access to a wider range of information than is necessary for the Board to carry out its statutory mission.

As an additional safeguard, we believe that Proposed Rule 4006 should contain reasonable limitations on the Board's ability to copy accounting firm records. The Board declined to incorporate a "demonstration of need" standard into the rule on the grounds that such a standard would hamper the Board's ability to conduct a rigorous inspection program and could result in needless disagreements about the Board's need for copies of particular documents.[33] Client confidentiality dictates, however, that firms and their clients should have some greater measure of protection than the Board's assurance that it "expects to only make and remove copies of documents it needs."[34] This is particularly true in view of the Board's position that it will not as a general matter honor assertions of state-law or professional nondisclosure obligations and will not recognize an accountant-client privilege. Accordingly, we believe that

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[33] Release at A2-15.

[34] *Id*.

Proposed Rule 4006 should be revised to require that the Board, in order to obtain copies of records, must demonstrate a reasonable need that cannot be met merely by having access to those records.

IV. PROPOSED RULE 4007: PROCEDURES CONCERNING DRAFT INSPECTION REPORTS

Section 104(f) of the Act directs the Board, in its rules, to "provide a procedure for the review of and response to a draft inspection report by the registered public accounting firm under inspection." Proposed Rule 4007 sets forth a procedure for firms to review and to respond to draft inspection reports prior to the Board's issuance of a final report. We believe that Proposed Rule 4007 contains a number of deficiencies. Because the final inspection report will constitute the primary written record of a firm's inspection results, a fair and comprehensive process for reviewing and responding to draft inspection reports is critical to the accuracy of the final report. To facilitate this goal, we recommend making a number of vital changes to Proposed Rule 4007.

A. THE PROPOSED RULES SHOULD ARTICULATE GUIDELINES ON WHEN INFORMATION INCLUDED IN A FIRM'S RESPONSE TO A DRAFT INSPECTION REPORT WILL BE TREATED CONFIDENTIALLY

Under Section 104(f) of the Act, where a firm submits a response to an inspection report, the response must be attached to and made part of the report, subject to the requirement that the response be "appropriately redacted to protect information reasonably identified by the accounting firm as confidential." Proposed Rule 4007 provides that the Board will redact from a response "any information for which [a] firm requested confidential treatment and which it is reasonable to characterize as confidential."[35] In our comment letter to the Board, we suggested

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[35] Proposed Rule 4007(b)(2).

that the Board articulate guidelines as to when it is "reasonable" to characterize as confidential information in a firm's response to a draft inspection report for which the firm has requested confidential treatment.[36] The Board did not incorporate our suggestion and expressly declined "to articulate guidelines to describe *categorically*" the types of information that could reasonably be considered confidential.[37] Although "categorical" guidelines may not be possible given the factual nature of determinations about confidentiality and reasonableness, the process of reviewing and responding to draft inspection reports can be meaningful only if firms have the freedom to be candid in their responses. In situations where responding accurately and completely to a draft inspection report would necessitate the disclosure of confidential information, if a firm does not know what will be treated as confidential, a firm may be reluctant to respond – and potential errors or inaccuracies in a report could go uncorrected. To promote candor in the review process, the proposed rules should provide some guidelines or examples as to when information may reasonably be considered confidential. In addition, the rules should permit a firm to withdraw portions of its response for which it has requested confidential treatment if the Board denies that request.

B. Firms Should Have A Right To Review And Respond To Revised Draft Inspection Reports

As discussed above, Section 104(f) of the Act requires the Board's rules to provide a procedure for "the review of and response to a draft inspection report." However, where the Board continues or supplements an inspection or revises a draft report prior to issuing a final

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[36] D&T Comment at 14.

[37] Release at A2-20 (emphasis added).

report, under Proposed Rule 4007(c), the Board is under no obligation to provide firms an opportunity to review and respond to the revised report. Although *de minimis* changes or additions to a draft inspection report may not merit a second round of review, we believe that, in order to ensure accurate inspection reports, the Board should strike a more appropriate balance by establishing a procedure that permits review in appropriate, clearly defined circumstances that are not left entirely to the Board's discretion. This could be accomplished, for example, by incorporating into Proposed Rule 4007 the Board's stated intention to allow firms to comment on revised reports "when new findings or assessments have been made or, more generally, when significant changes have been made to the draft report by the Board."[38]

V. PROPOSED RULE 4008: PROCEDURES CONCERNING FINAL INSPECTION REPORTS

THE PROPOSED RULES SHOULD INCLUDE RESTRICTIONS ON THE DISCLOSURE OF FINAL INSPECTION REPORTS BY RECIPIENT AGENCIES

The Board rejected our proposal that its Proposed Rule 4008 specify the proper treatment of final inspection reports once given to the agencies specified in the Act. Specifically, we suggested that the rule make clear that state freedom-of-information or open-records laws are preempted to the extent that they would require or permit the disclosure of a final inspection report.[39] In addition, we proposed that the rule forbid the disclosure of information to any agency except under a confidentiality agreement.[40]

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[38] Release at A2-23; Notice, 69 Fed. Reg. at 22107.

[39] D&T Comment at 17-18.

[40] *Id.* at 18.

The Board responded to these comments with a statement that, except as otherwise provided in Section 104(g)(2) of the Act, final inspection reports are subject to the confidentiality protections of Section 105(b)(5)(A) and state regulators that receive final inspection reports are bound by the express requirement in Section 105(b)(5)(B) to maintain such reports as confidential and privileged.[41] The Board went on to state that "[a]ny otherwise applicable state or local law that conflicts with this requirement or stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress would be preempted."[42]

Although we understand that making final inspection reports available to the SEC and other agencies, as well as to the public, is contemplated by the Act,[43] we are concerned that, unless the text of Proposed Rule 4008 is clarified, such availability may be effectuated in a manner inconsistent with the Act's provisions protecting the confidentiality of this information.[44] The Board stated in its investigations release that it would not concern its rules with the treatment of investigatory information once in the hands of recipient agencies, on the theory that the matter is the exclusive province of the Act.[45] Yet, elsewhere in its proposed

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[41] Release at A2-27 to -28; Notice, 69 Fed. Reg. at 22108.

[42] Release at A2-28; Notice, 69 Fed. Reg. at 22108.

[43] Act §§ 104(g), 105(b)(5)(B).

[44] *Id*. § 105(b)(5)(B)(ii)(IV) (requiring that "each of [the agencies receiving information prepared or received by or specifically for the Board in connection with an inspection] maintain such information as confidential and privileged").

[45] Rules on Investigations and Adjudications, PCAOB Release No. 2003-015, at A2-42 (Sept. 29, 2003); Public Company Accounting Oversight Board; Notice of Filing of Proposed Rules

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rules, the Board provides its interpretation on other matters that are equally the exclusive province of the Act. Accordingly, we believe that the proposed rule should explicitly provide that recipient agencies may not make further disclosure of final inspection reports except to the extent permitted under Section 104(g) of the Act. Moreover, although we welcome the clarification that the Board has provided regarding preemption in the inspections context, the Board has taken no steps to articulate the restrictions that the Act places on such agencies or the contours that the preemptive effect would have.

VI. PROPOSED RULE 4010: BOARD PUBLIC REPORTS

THE BOARD'S AUTHORITY TO ISSUE PUBLIC REPORTS SHOULD BE CIRCUMSCRIBED BY THE CONFIDENTIALITY PROTECTIONS SET FORTH IN THE ACT AND ELSEWHERE IN THE BOARD'S RULES

Proposed Rule 4010 permits the Board to publish summaries, compilations, or other general reports about Board procedures, findings, and inspection results "[n]otwithstanding any provision of Rules 4007, 4008, and 4009." This language suggests that the Board, in acting under Proposed Rule 4010, could ignore the confidentiality protections found in other rules and in the Act. The rule should clearly state that those confidentiality limitations apply to public releases made under this rule as well.

In our comment letter to the Board, we suggested that the Board revise Proposed Rule 4010 to incorporate the restrictions on disclosure of confidential information mandated by

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Relating to Investigations and Adjudications, 69 Fed. Reg. 15394, 15399 (Mar. 25, 2004); *see also* Release at A2-9 (stating, in the context of referrals and reporting of information regarding possible violations under Proposed Rule 4004, that "it is the Act, rather the Board's rules, that directs the recipients of the information to maintain such information as confidential and privileged").

Section 104(g)(2),[46] and thereby expressly exclude from any released report information afforded confidential treatment, information prepared specifically for or received by the Board (as set forth in Section 105(b)(5)(A) of the Act),[47] and portions of reports that deal with criticisms of or potential defects in a firm's quality control systems.

We commend the Board for stating in the Release that it does not intend to issue public reports in a manner that identifies the firm or firms involved, directly or indirectly.[48] However, the Board did not make any changes to Proposed Rule 4010 in response to the confidentiality concerns addressed in our comment letter, stating that because the proposed rule does not implement Section 104(g)(2) of the Act, the Board is not bound by the confidentiality provisions of Section 104(g)(2) in issuing public reports.[49] In light of this statement, it is unclear where the Board derives its authority to issue public reports, as provided in Proposed Rule 4010, about the procedures relating to, and the findings and results of, its inspections.

Moreover, we believe that public disclosure of certain information that is otherwise exempt from disclosure under Proposed Rules 4007, 4008, and 4009 would be wholly inappropriate because it would be inconsistent with the requirements of the Act and other

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[46] D&T Comment at 22-24.

[47] As the Board has noted, a final inspection report would generally be covered by Section 105(b)(5)(A)'s confidentiality protection because it is a document prepared by the Board in connection with an inspection. It is also likely to contain substantial information received by the Board in connection with an inspection and therefore is independently subject to the protection of Section 105(b)(5)(A). A final inspection report "is also unique, however, in that the Act separately contemplates, in Section 104(g)(2), that at least some portions of it will be publicly available." Release at A2-27; Notice, 69 Fed. Reg. at 22108.

[48] Release at A2-34.

[49] *Id*.

provisions of the Board's proposed rules. The proposed rule would permit the Board to disclose to the public: (1) information contained in draft inspection reports (Proposed Rule 4007); (2) information that firms include in their responses to draft inspection reports and that the Board has agreed to treat as confidential (Proposed Rule 4007(b)(2)); (3) information contained in final inspection reports that the Board determines, in the exercise of its discretion, is not appropriate for transmission to state regulatory authorities (Proposed Rule 4008); and (4) certain information about criticisms of and potential defects in quality control systems (Proposed Rule 4009). Moreover, the prohibition in Proposed Rule 4010 on disclosure of firm-specific information covers only information pertaining to potential defects in and criticisms of quality controls.

Draft inspection reports, which are covered by Proposed Rule 4007, are confidential under the plain language of Section 105(b)(5)(A) of the Act because they constitute "information prepared . . . by . . . the Board . . . in connection with an inspection." Moreover, we do not believe that the Board should have the authority under Proposed Rule 4010 to disclose publicly information contained in a draft inspection report before a firm has had the opportunity to respond to the report, as required by Section 104(f) of the Act and Proposed Rule 4007. Similarly, allowing the Board to disclose information in a firm's response to a draft inspection report, when Section 104(f) of the Act and the Board's own rules require that the firm's response be redacted to protect confidential information, would eviscerate the protections afforded to firms under the confidentiality provisions of the Act and Proposed Rule 4007.

With regard to Proposed Rule 4009, Section 104(g)(2) of the Act expressly states that "no portions" of an inspection report that deal with criticisms of, or potential defects in, a firm's quality control systems can be made public if the criticisms or potential defects are addressed to the Board's satisfaction no later than 12 months after the date of the inspection report. In view

of the clear statutory requirement, we do not believe that the Board has the authority to make even generalized disclosures under Proposed Rule 4010. Moreover, we have concerns that permitting disclosure under Proposed Rule 4010 of even general information relating to the quality control systems of ostensibly unnamed firms could result in disclosure of a firm's identity. For these reasons, we believe that the Board's authority under Proposed Rule 4010 to make public disclosure of procedures, findings and inspection results should be subject to, rather than exempt from, the confidentiality provisions in Proposed Rules 4007, 4008, and 4009.

VII. PROPOSED RULE 4001: REGULAR INSPECTIONS

ONGOING AUDIT ENGAGEMENTS SHOULD BE EXEMPT FROM REGULAR INSPECTIONS

Proposed Rule 4001 provides that the procedures the Board performs in connection with inspections must include an inspection and review of "selected audit and review engagements" of firms, as set forth in Section 104(d)(1) of the Act. We suggested in our comment letter to the Board that the Board revise Proposed Rule 4001 to exclude from "selected audit and review engagements" those engagements that are ongoing at the time an inspection is conducted.[50] The Board did not incorporate our suggestion. We believe that it would be inappropriate for the Board to examine engagements that are in progress as part of an inspection for several reasons. First, an interim examination necessarily would result in a distorted picture of those engagements because the Board would not have complete, comprehensive information about the engagements in conducting its inspections. In addition, a midstream inspection would be unduly disruptive to an audit. Firms would be forced to divert valuable resources away from performing audits in order to compile documents and to respond to Board requests for information related to ongoing

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[50] D&T Comment at 7.

engagements. This would, at best, be distracting to firms and their personnel and, at worst, could compromise audit quality. For these reasons, we believe that the Board's resources would be more appropriately focused on examining audit engagements that have been completed.

CONCLUSION

The Commission should not approve the Board's rules as currently drafted. The defects identified above prevent the proposed rules from achieving the clarity that is necessary for registered public accounting firms to understand and to respond appropriately to the requirements associated with inspections. The Commission would not be able to review the product of the Board's inspection process in a manner consistent with the Act, the Administrative Procedure Act, and the Constitution unless the proposed rules are substantially revised. The Commission either should modify the proposed rules to ensure that the Board's procedures are fair, balanced, and clear, or should remand the proposed rules to the Board with specific instructions for the Board to do so.

We would be pleased to discuss these issues with you further. If you have any questions or would like to discuss these issues further, please contact Robert J. Kueppers at (203) 761-3579 or Philip R. Rotner at (212) 492-4012.

Very truly yours,

/s/ Deloitte & Touche LLP

cc: Chairman William H. Donaldson
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Commissioner Roel C. Campos

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