Deloitte & Touche LLP
Ten Westport Road
P.O. Box 820
Wilton, CT 06897-0820
USA

Tel: 203-761-3000
Fax: 203-834-2200
www.deloitte.com

April 3, 2006

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

Re: File No. PCAOB–2006–01.

Dear Ms. Morris:

Deloitte & Touche LLP is pleased to respond to the request for comments from the Securities and Exchange Commission (the "Commission") on the *Proposed Ethics and Independence Rules Concerning Independence, Tax Services, and Contingent Fees* (the "Proposed Rules") filed with the Commission by the Public Company Accounting Oversight Board (the "Board" or "PCAOB"), Release No. 34–53427; File No. PCAOB–2006–01 (March 7, 2006) (the "Release").[1] We participated in the Board's own comment process[2] and hope that this submission will be useful to the Commission as it reviews the rules proposed by the Board.

Introduction

Deloitte & Touche LLP appreciates the opportunity to submit these comments to the Commission. We strongly support the goals of the Sarbanes-Oxley Act of 2002 (the "Act") and the efforts of both the Commission and the Board to achieve those goals through rulemaking. Recognizing that the Board faced difficult and sensitive judgments in crafting the Proposed Rules, we believe that the Proposed Rules represent a thoughtful approach on the part of the Board to further the goals of the Act. Accordingly, we support approval of the Proposed Rules by the Commission.

With that support in mind, we offer the following comments for consideration. These comments are largely aimed at achieving effective and efficient implementation of, and compliance with, the Proposed Rules, without altering the Board's fundamental premise or rationale for them. For the rules to work, we believe that all of the parties impacted (e.g., issuers, audit committees and practitioners) must have both a clear understanding of the scope of the Proposed Rules and the ability to effectively apply them and monitor compliance. When the scope or application of a rule is unclear, both premises are in jeopardy. For that reason, our comments will primarily address areas where we believe clarification of the Proposed Rules would enhance compliance and address issues in their application in today's complex global business environment. We have also responded to specific questions posed by the Commission in the Release.

We recognize that the Commission may have limited ability to modify portions of the Proposed Rules without instituting proceedings to determine whether the Proposed Rules should be disapproved in their

[1] 71 Fed. Reg. 12720 (March 13, 2006).
[2] *See* Letter from Deloitte & Touche LLP to the PCAOB dated February 14, 2005.

entirety. For that reason, where possible, we have attempted to limit our comments to areas that may be addressed through an adopting release clarification of, rather than through modification of, the rules. We therefore encourage the Commission to include clarifying commentary with any order to approve the Proposed Rules. Moreover, we urge the Commission to give consideration to subsequent, stand-alone guidance (e.g., FAQ's) aimed at clarifying any final rules. Without such additional guidance, impacted parties will likely find it necessary to seek guidance regarding uncertain issues on a case-by-case basis directly from the staff of the Commission or the staff of the Board, which does little to benefit the public at large and places an unnecessary burden on the already limited resources of the Commission and the Board.[3] Where our comments may lead the Commission to believe that a rule needs to be modified, rather than simply clarified, we would encourage the Commission to pursue such modification through subsequent discussions with the Board, rather than through proceedings to disapprove the Proposed Rules in their entirety.

Comments

In providing our comments, we have chosen to follow the order of the Proposed Rules. Accordingly, the order of our comments in no way reflects the importance that we place on each aspect of the Proposed Rules.

1. Proposed Rule 3502: Responsibility Not to Knowingly or Recklessly Contribute to Violations

We agree with the Board that persons associated with public accounting firms have a duty not to violate the Act, or the related rules adopted by the Commission and by the Board. We also appreciate the significant improvements in the current proposed language for Rule 3502 that the Board made after considering the comments submitted in response to the initial proposal for this rule. In particular, we are pleased that the Board has moved away from its initial proposal that would have exposed associated persons to sanctions for merely negligent acts or omissions. In addition, and as we noted in our earlier comments to the Board, the initial proposed rule would have placed all individuals who "contribute to a violation" at risk for disciplinary sanctions, without any guidance as to what individual actions would be viewed as "contribut[ing]" to the firm's violation. We therefore appreciate the Board's efforts to clarify the reach of the rule by stating that an associated person's actions or omissions fall within the rule only if they "take or omit to take an action knowing, or recklessly not knowing that the act or omission would directly and substantially contribute to a violation" by the accounting firm.

We understand from the main body of the Release accompanying Rule 3502 -- which repeatedly states that associated persons may "cause" a firm to violate the applicable laws and rules[4] -- that the Board apparently intended the rule only to reach individual behavior that knowingly "causes" violations by accounting firms, and we support such a rule. The standard of intentionally causing a violation of the Act is the appropriate standard for the Board to apply.

However, the formulation used by the Board in the rule itself -- "directly and substantially contribute" -- may produce undue confusion as a result of the language by which the Board undertakes to explain what that phrase means. In the Release, individuals associated with public accounting firms are warned that

[3] Before proceeding to our substantive comments, we would like to note our concern regarding the new statement from the Board, released only this past week on March 28, 2006, proposing yet more changes to the transition period incorporated in the Commission's notice published in the Federal Register three weeks ago. It is not clear how the new transition timeline proposal by the Board will intersect with this rulemaking, and we urge the Commission to clarify that issue.

[4] 71 Fed. Reg. at 12722, 23, 24.

their acts or omissions may "substantially contribute" if they contribute to a violation "in a material or significant way," and that their acts or omissions may "directly contribute" to a violation by providing "a reasonably proximate facilitating event of, or a reasonably proximate stimulus for, [a] violation." Their actions or omissions need not be "the sole cause of the violation," nor need they be "the final step in a chain of actions leading to the violation."[5] This vague and imprecise language, used to explain a causation standard, ultimately detracts from the clarity of the text of the Proposed Rule, and departs from the use of the term "cause" in the Release.

The Release asserts that references to an associated person "caus[ing]" a violation were removed from the title and text of Proposed Rule 3502 as a "technical" amendment designed to avoid any "misperception that the rule affects the interpretation of any provision of the federal securities laws."[6] There is no reason for such concern. We believe that the Board's stated concern -- that its rules not be seen as altering the meaning of the federal securities law -- can best be addressed by a straightforward statement in the Commission's release adopting Rule 3502 that it is adopting the meaning of "cause" as that term is used in the interpretation of the securities laws and SEC regulations. Under the Sarbanes-Oxley Act, the conduct targeted by Rule 3502 is a violation of the securities laws, and the existence of any such violation should be determined by a single standard. The language in the Release risks establishing a second, entirely new standard for determining when the securities laws have been violated. The Commission should prevent the emergence of two such different standards, and confirm by way of clarification that "cause" is the appropriate standard under Rule 3502.

Finally, the Board's discussion of Rule 3502's causation standard implicitly assumes that no liability can attach unless the accounting firm with which an individual is associated is first found to have violated the securities laws or the Commission's or Board's rules.[7] We concur with that implicit assertion, and we believe that this principle should be made explicit in the final rule by adding a clarification that a finding of an actual violation by the firm is a prerequisite to any finding that an individual violated Rule 3502.

2. Proposed Rule 3521: Contingent Fees

Proposed Rule 3521 provides that a registered public accounting firm is not independent of its audit client if the firm, or any affiliate of the firm, during the audit and professional engagement period, provides any service or product to the audit client for a contingent fee or a commission, or receives from the audit client, directly or indirectly, a contingent fee or commission. This Proposed Rule was adapted from a similar Commission rule generally prohibiting contingent fee arrangements.[8]

We are concerned that neither Proposed Rule 3521, nor the Commission's rule, articulates a transition policy for companies that may become public audit clients of an audit firm from which the companies have received services pursuant to a contingent fee arrangement. For example, without a transition policy, a private company attempting to go public through an initial public offering may have limited options when selecting an outside auditor if it has been provided services pursuant to contingent fee arrangements from several accounting firms within the period covered by its initial public financial

[5] *Id.* at 12724.
[6] *Id*. at 12735.
[7] *See id.* at 12724 (stating that an individual may be sanctioned if his conduct "constitutes the violation" or is a facilitating event of, or stimulus for, "the violation").
[8] *See* Rule 2-01(c)(5) of Regulation S-X, 17 C.F.R. 210.

statements.[9] Similarly, the ability for a public company to change audit firms may be limited by contingent fee arrangements in place with several audit firms.

To address these very real issues, we recommend that the Commission adopt a transition policy (applicable to both Proposed Rule 3521 and the Commission's rule) providing that a contingent fee arrangement will not impair the independence of an audit firm if that arrangement is paid in its entirety, converted to a fixed fee arrangement, or otherwise unwound within a certain period of time after the company becomes an audit client of the firm with which the arrangement exists (e.g., the sooner of 90 days or the issuance of a report on the audited financial statements of the audit client).

In addition, significant uncertainty exists with respect to the concept of "indirect" contingent fees. We are concerned that application of this concept may result in inadvertent violations of the rule where neither the audit client nor its affiliates are direct parties to a contingent fee arrangement. Accordingly, to address this uncertainty, we request clarification that the Proposed Rule's reference to "indirect" contingent fees only addresses, and is limited to, situations where the audit firm directly enters into contingent fee arrangements with affiliates of an audit client. If such clarification is not given, it should at least be made clear that the reference to "indirect" contingent fees is specifically intended to address, and is limited to, situations where the auditor deliberately attempts to craft business arrangements with third parties to circumvent the contingent fee rules.

3. Proposed Rule 3522: Tax Transactions

A. Proposed Rule 3522(a): Confidential Transactions is potentially broad-reaching

Proposed Rule 3522(a) provides that a registered public accounting firm is not independent of its audit client if the firm, or any affiliate of the firm, during the audit and professional engagement period, provides any non-audit services to the audit client related to marketing, planning, or opining in favor of the tax treatment of a confidential transaction.

Proposed Rule 3522(a) appears to define confidentiality in terms of confidentiality restrictions imposed by tax advisors generally, not just those employed by an audit firm. Accordingly, under Proposed Rule 3522(a), independence may be impaired when an auditor opines in favor of the tax treatment of a transaction and conditions of confidentiality have been imposed by another tax advisor, acting independent of the auditor. As we observed in our previous comments submitted to the Board, this restriction imposes an undue burden upon the audit firm to determine whether confidentiality restrictions may have been imposed on a transaction by another, completely unrelated tax advisor. This is particularly worrisome given the fact that the term "conditions of confidentiality" has been construed broadly for U.S. tax purposes and may include terms and provisions that are not normally regarded as conditions of confidentiality in many foreign countries.

We note that the Board has amended Proposed Rule 3522(b) to bar an accounting firm from marketing, planning, or opining in favor of aggressive tax transactions only when the transaction in question was initially recommended by the accounting firm or its affiliates. In so doing, the Board explicitly acknowledged that accounting firms might not know when a particular transaction was proposed by an outside tax advisor or instead originated from the audit client,[10] and decided not to impose an unworkable

[9] For additional commentary on this significant issue, *see* AUDITING: A PROFESSION AT RISK, U.S. Chamber of Commerce (January, 2006).
[10] *See* 71 Fed. Reg. at 12728.

obligation on accounting firms to investigate the origins of such tax transactions. If not clarified, the current form of Rule 3522(a) could create, in a different context, the very problem that the Board sought to avoid in amending Rule 3522(b). Accordingly, we recommend clarification that Proposed Rule 3522(a) is limited to circumstances where conditions of confidentiality have been imposed directly by the audit firm, its affiliates, or another tax advisor with which the audit firm has a formal agreement or other arrangement related to the promotion of the transaction at issue.

Alternatively, we request clarification from the Commission that any obligation on part of the audit firm to determine that no conditions of confidentially have been imposed by another tax advisor may be met by obtaining representations to that effect from the audit client, provided that the audit firm does not know, or have reason to know, that those representations are incorrect or incomplete.

B. Proposed Rule 3522(b): Clarification regarding subsequent "listing" of transactions

The Commission has specifically requested comments on the Board's discussion of the impact on an auditor's independence when a transaction that the auditor planned or opined on subsequently becomes a "listed transaction" under applicable Treasury Regulations. Specifically, the Commission asks:

> *Is it 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 the independence from the date of the listing forward? Is additional guidance necessary regarding the consideration of an auditor's independence when a transaction planned or opined on by the auditor subsequently becomes listed?*

In responding to the Commission's request, we want to stress our belief that clarity and certainty when applying these rules is of critical importance to all parties involved (e.g., issuers, audit committees and practitioners). Accordingly, we appreciate the Commission's efforts to solicit comments aimed at adding clarity to this portion of the Proposed Rules. While we believe that the discussion included in the Board's release attempts to make it clear that the subsequent listing of a transaction, while not in and of itself independence impairing, *could* impact independence from the date of the listing forward, the current language of the Proposed Rule itself is unclear on this point. Note 1 accompanying Proposed Rule 3522(b), on its face, leaves open the possibility that an accounting firm could potentially have its independence impaired, both retroactively and prospectively, if a transaction it previously recommended later becomes listed.[11] Accordingly, we believe that additional guidance is necessary regarding the consideration of an auditor's independence once a transaction becomes listed.

When considering this Proposed Rule, it is important to recognize that the Internal Revenue Service's designation of a transaction as a "listed transaction" is largely a mechanism aimed at information gathering. That is, listed transactions are subject to higher levels of disclosure and Internal Revenue Service scrutiny than are non-listed transactions. Nevertheless, listing a transaction does not *per se* mean that the transaction violates relevant tax laws or otherwise lacks substantive merit or support. This is demonstrated by the fact that in certain instances, the Internal Revenue Service has identified transactions as listed transactions, only to subsequently "delist" them after gathering enough information to be satisfied that the transactions were not abusive tax avoidance transactions.[12]

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[11] *See id.* at 12721.

[12] *See, e.g.*, Notice 2004-67, 2004-2 C.B. 600 (Oct. 12, 2004) (delisting two previously listed transactions).

On that basis, we do not believe that it is appropriate for independence determinations to be keyed solely off the subsequent designation of a transaction as a "listed" transaction. To do so would sacrifice clarity and certainty that is critical in this area and run the risk of premature or unfounded independence concerns. Rather, it should be made clear that a subsequent listing of a transaction has no retroactive impact on independence and does not *per se* impair independence going forward. To accomplish this, we recommend that the Commission clarify that the reference to "listed transaction" in Note 1 accompanying Proposed Rule 3522(b) should be read to include only those transactions that were listed at the time the accounting firm, or any affiliate of the firm, provided any non-audit service to the audit client related to marketing, planning, or opining in favor of the tax treatment of the transaction.

It should also be made clear that any determination as to the impact on auditor independence of a transaction that subsequently becomes listed should rest primarily with the audit committee. Where an auditor has planned or opined on a transaction that subsequently becomes a listed transaction, it would certainly be appropriate for the auditor to promptly revisit that transaction, and the auditor's related services, with the client's audit committee. The audit committee should consider the independence implications of the auditor's involvement with the transaction, giving significant consideration to the three prong test for aggressive tax transactions articulated in Proposed Rule 3522(b).[13]

4. Proposed Rule 3523: Tax Services for Persons in Financial Reporting Oversight Roles

Proposed Rule 3523 provides that a registered public accounting firm is not independent of its audit client if the firm, or any affiliate of the firm, during the audit and professional engagement period provides any tax service to a person in a financial reporting oversight role at the audit client, or an immediate family member of such person, unless certain limited exceptions apply.

A. Rule 3523 should apply only at the "issuer" level

Proposed Rule 3523 generally extends beyond individuals in a financial reporting oversight role at the issuer, to include such individuals at the "audit client" (essentially the issuer and its affiliates). This would include any entity affiliated with the issuer (e.g., domestic and foreign subsidiaries), unless the entity is not material to the issuer's consolidated financial statements or the entity's financial statements are audited by another audit firm.[14]

Such a broad application of the Proposed Rule makes monitoring compliance with the rule extremely burdensome. To avoid violations of the rule, audit firms who serve large, multinational companies would need to establish complex systems to attempt to cross-check individual tax services being provided by staff around the world with lists of audit client affiliates and their employees functioning in potential financial reporting oversight roles. Even if such systems could be created, continual and subjective determinations of which audit client affiliates are "material" and which executives at those affiliates truly function in financial reporting oversight roles would need to be made, adding to the burden. In the context of an investment company complex, monitoring compliance becomes even more difficult, given the broad affiliation rules applicable to such entities and the frequency with which the makeup of the complex may change. Accordingly, we recommend that Proposed Rule 3523 be applied only to individuals in a financial reporting oversight role at the issuer.

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[13] Proposed Rule 3522(b) provides, in general, that independence is impaired when an auditor provides non-audit services to the audit client related to marketing, planning, or opining in favor of the tax treatment of a transaction that was initially recommended by the auditor, and a significant purpose of which is tax avoidance, unless the proposed tax treatment of the transaction is at least more likely than not to be allowed under applicable tax laws.

[14] *See* Proposed Rule 3523(b).

As additional support for this comment, we note the Commission's final independence rule addressing conflicts of interest resulting from employment relationships.[15] That rule, which the Board referenced in defining the term "financial reporting oversight role," generally requires a one year "cooling off" period before a key member of an audit engagement team may begin working for an issuer in a financial reporting oversight role. The scope of the rule, as originally proposed, was similar to that of Proposed Rule 3523, i.e., it applied to the "audit client" (including affiliates), and not just the issuer. However, in promulgating the final rules in 2003, the Commission recognized the difficulties in applying and monitoring a rule with such a potentially broad scope, and opted to limit the scope of the rule to include only the issuer. The Commission stated:

> We agree with the commenters who noted that extending the requirement to the "audit client" might be difficult to monitor because of the potentially broad scope of the defined term–particularly in situations where a member of the audit engagement team begins employment with an affiliate of the audit client. Accordingly, the rules that we are adopting apply to employment relationships entered into between members of the audit engagement team and the "issuer."[16]

We believe that the difficulties in applying and monitoring Proposed Rule 3523 are even more significant than those recognized by the Commission when considering the "cooling off" period rule, which necessarily involves key members of the audit engagement team with significant knowledge regarding the issuer and its affiliates. In the case of Proposed Rule 3523, a violation could occur, for example, if a junior practitioner employed by one of the auditor's foreign affiliates provides tax services to an executive in a financial reporting oversight role at a foreign affiliate of the issuer, at that executive's request and without any acknowledgement of the relationship to the ultimate issuer. A violation would occur even if that practitioner has no connection whatsoever to the audit engagement team and was not aware of the executive's role in the foreign affiliate. For these reasons, we urge the Commission to consider the scope of Proposed Rule 3523 and limit its application to individuals in a financial reporting oversight role at the issuer.

B. Rule 3523(c) exception should include individuals who become subject to the rule due to corporate "life events"

Proposed Rule 3523(c) provides a limited exception to the general limitation on tax services for persons in a financial reporting oversight role if the person was not in a financial reporting oversight role at the audit client before a hiring, promotion, or other change in employment event and the tax services are (1) provided pursuant to an engagement in process before the hiring, promotion, or other change in employment event; and (2) completed on or before 180 days after the hiring or promotion event. We believe that this exception is critical for two reasons: first, to minimize the risk of an inadvertent violation of the Proposed Rule, and second, to minimize undue hardship on persons who become subject to the rule because they are hired or promoted into a financial reporting oversight role at an audit client.

We also believe, however, that additional clarification is necessary to ensure that this exception applies to persons who become subject to the rule as a result other corporate "life events." For example, inadvertent violations of the Proposed Rule could arise with respect to persons who become subject to the rule because their privately held employers (or their public company employers that did not use the services of

[15] *See* Rule 2-01(c)(2)(iii)(B) of Regulation S-X, 17 C.F.R. 210.
[16] Strengthening the Commission's Requirements Regarding Auditor Independence; Final Rule; 68 Fed. Reg. 6006, 6008 (Feb. 5, 2003) (citations omitted).

the audit firm) become public audit clients of a firm as a result of mergers, acquisitions or initial public offerings. Similarly, such persons face the same potential for undue hardship through a merger, acquisition or offering as persons who become subject to the rule through a promotion within an already public company. We also note the potential hardships on companies attempting to access the public capital markets. For example, a private company attempting to go public through an initial public offering may have limited options when selecting an outside auditor if its executives have received tax services from several accounting firms within the period covered by its initial public financial statements.

For these reasons, we request that the Commission clarify that the phrase "other change in employment event" as set forth in Proposed Rule 3523(c) includes corporate events involving the person's employer, including mergers, acquisitions, initial public offerings or other events that result in the person becoming subject to the Proposed Rule.

C. Allowable services under Rule 3523 should be clarified

The release that accompanied the Proposed Rules indicates that persons in a financial reporting oversight role can seek the assistance of the registered public accounting firm that prepared an original tax return to assist them in responding to an IRS or other governmental agency examination of that specific tax return after Rule 3523 becomes effective. The Board states:

> If a registered firm prepared such a tax return before the rule's effective date, the rule does not operate to prohibit that person from answering questions and providing assistance when that tax return is under examination by a taxing authority after the rule's effective date.[17]

We believe that this relief is intended to apply to all situations in which a person becomes subject to the rule, whether due to the initial effective date of the rule, a hiring, promotion or other employment event, or, as described above, a merger, acquisition, initial public offering or other corporate event. Unfortunately, the Board's discussion, which speaks in terms of *the rule's effective date*, makes the scope of the relief somewhat unclear. Accordingly, we request clarification that if a registered firm prepared a person's tax return before that person was subject to Rule 3523 (i.e., because they were not in a financial reporting oversight role at a public company audit client), the rule does not prohibit the audit firm from answering questions and providing assistance if that tax return is under examination by a taxing authority after that person becomes subject to the rule.

Conclusion

We strongly support the efforts of both the Commission and the Board to further the goals of the Act, and generally believe that the Proposed Rules represent a thoughtful approach to furthering those goals. Nevertheless, we firmly believe that to be effective, all of the parties impacted by the Proposed Rules must have both a clear understanding of the scope of the rules and the ability to effectively apply them and monitor compliance. Accordingly, we respectfully request that you give full consideration to our comments which are largely aimed at ensuring both premises.

We appreciate your consideration of the suggestions and views set forth herein, and look forward to working with the Commission and the Board to achieve clarity in any final rules.

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[17] 71 Fed. Reg. at 12731, n.54.

If you have any questions, please contact Robert Kueppers at (212) 492-4241 or Roger Page at (202) 879-5630.

Sincerely,

Deloitte & Touche LLP

Deloitte & Touche LLP