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April 3, 2006

Nancy M. Morris, Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

PCAOB Proposed Ethics and Independence Rules Concerning Independence, Tax Services, and Contingent Fees, SEC Release No. 34-53427; File No. PCAOB-2006-01

Dear Ms. Morris:

Ernst & Young LLP ("E&Y") is pleased to submit this comment letter on the Public Company Accounting Oversight Board's ("PCAOB") Proposed Ethics and Independence Rules Concerning Independence, Tax Services, and Contingent Fees ("Proposed Rules").

As a preliminary matter, we note that we submitted comments to the PCAOB on the initial PCAOB proposed rule, and in those comments we stated our strong support for the PCAOB's rulemaking initiative. We believe that audit committees, regulators, and the investing public will benefit from greater clarity as to what is, and what is not, permitted under the relevant independence rules. The Proposed Rules would add clarity as to how the auditor independence restrictions apply to the provision of tax services. In our view, the PCAOB has drawn a well-considered line between permissible and impermissible tax services.

The SEC's Release asks for comments on two issues. First, the Release asks whether "the proposed rules are consistent with the requirements of Title I of the [Sarbanes-Oxley] Act." Notice of Filing of Proposed Ethics and Independence Rules Concerning Independence, Tax Services, and Contingent Fees, Release No. 34-53427, File No. PCAOB-2006-01, 71 Fed. Reg. 12, 720, 12,735 (March 13, 2006) ("SEC Release"). Section 103(b) of the Act directs the Board to establish such rules on auditor independence "as may be necessary or appropriate in the public interest or for the protection of investors, to implement, or as authorized under, Title II of th[e] Act." The PCAOB has analyzed this matter thoroughly and has concluded that, for the protection of investors, accounting firms should not be permitted to provide certain tax services to their audit clients. The PCAOB identified these specific services and, based on a full administrative record, concluded that these services might impair an audit firm's independence. Thus, we believe that the rules are consistent with the Act.

Second, the Release asks for comment on a specific issue under proposed Rule 3522. That rule would prohibit accounting firms from recommending "aggressive tax position transactions," which are defined as including transactions that have been "listed" by the Internal Revenue Service ("IRS"). As the Release notes, the Board stated that there may be a "potential impairment" of independence where a company's audit firm recommends a transaction which is unlisted at the time of the recommendation and is listed subsequently. The Board declined to adopt a bright-line rule on this issue, and instead stated that the independence analysis "depend[s] on the circumstances." SEC Release, 71 Fed. Reg. at 12,729.

E&Y, in its comments to the PCAOB on its rule proposals, urged the PCAOB to adopt a clearer line, as did other commenters. In our view, no independence impairment should arise when a transaction that was not listed at the time an audit firm advised the audit client later becomes listed. The listing of a transaction is the notification by the IRS to taxpayers that the transaction may be potentially abusive; it does not represent a final conclusion and, in fact, the IRS has removed transactions from listed status on several occasions, thereby indicating the complexity of the factors considered in the application of the listing process. Assuming that the audit firm evaluated the appropriateness, from all relevant perspectives, of the tax engagement prior to pre-approval, discussed the nature of the transaction with the audit committee and received pre-approval, and was able to conclude at a "more likely than not" level of confidence upon implementation of the transaction, the subsequent listing should not impair the firm's independence.

The Board based its position on the potential "mutuality of interest" that would exist between the firm and its client as soon as the transaction is listed. Thus, "once a transaction is listed, either the audit client or the firm, or both, may be required to defend the tax treatment of the transaction and, in some cases, pay penalties." SEC Release, 71 Fed. Reg. at 12,729. Also, "the firm may face liability to the audit client related to the firm's tax advice." *Id*. Further, "[t]he auditor's judgment regarding appropriate financial reporting and disclosure concerning a transaction that becomes listed could become biased by the auditor's vested interests in defending its tax advice." *Id*. But these same or similar situations have long arisen in other contexts, without impacting independence. For example, an accounting firm's audit opinion might be called into question when the client is required to restate its financial statements, thereby giving rise to potential civil liability or penalties. That development, by itself, has not been thought to impair independence. Moreover, existing independence rules and principles govern these situations. In particular, ET Section 101.08 and FRR 602.02(f)(ii) provide that independence may be impaired by actual or threatened litigation between the client and its auditor; these provisions set forth factors for assessing independence in these situations. It seems much preferable to rely on these long-standing rules rather than to introduce the uncertainty that will likely result from the PCAOB's approach.

Another point is significant as well to this matter. The "more likely than not" standard in Rule 3522(c) is a considered a high threshold or standard. The PCAOB can use its inspection process to examine the basis for a firm's conclusion when a particular transaction later becomes listed. This is a significant additional safeguard against the promotion by accounting firms of inappropriate tax transactions.

We do not believe that it would be necessary for the SEC to disapprove the PCAOB's Proposed Rule because of the Rule 3522 issue discussed above, and, in fact, we urge approval. In our view, this specific matter can be clarified by the SEC in its adopting release.

Finally, two additional aspects of the Proposed Rules should be noted. Under Proposed Rule 3523, a firm lacks independence from its audit client if the firm provides a tax service to a person in a "financial reporting oversight role at the audit client" or "an immediate family member of such person." The definition of "audit client" includes, under Proposed Rule 3501(a)(iv), "any affiliates of the audit client." Rule 3523(b) does exclude immaterial affiliates and affiliates that are audited by a different accounting firm, but, because of the broad definition of "affiliates" under Proposed Rule 3501(a)(ii), and because of the inclusion of "immediate family member" in the restriction (defined by Proposed Rule 3501(i)(i) as "a person's spouse, spousal equivalent, and dependents"), the rule will sweep a large number of persons into its prohibitory reach. A concern is also raised by Rule 3501(c)(i), which defines "confidential transaction[s]" – that is, transactions that are essentially off-limits for accounting firms and their audit clients under Proposed Rule 3522(a) – as including "confidentiality restrictions imposed by tax advisors generally, not specifically auditors." SEC Release, 71 Fed. Reg. at 12,730. While accounting firms can eliminate confidentiality provisions in their own agreements with clients, it will be difficult to monitor effectively the contractual relationships our audit clients have with their other advisors – we presumably will need to rely on client representations. We note both of these rules in order to emphasize the significant compliance challenges and costs that will be imposed on the Ernst & Young global organization, which has member firms in more than 140 countries.

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We would be pleased to provide the Commission with additional information on the issues addressed by this letter.

Respectfully submitted,

Ernst + Young LLP