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April 20, 2018

Via Hand Delivery

Brent J. Fields
Secretary
Office of the Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: *In the Matter of the Application of Cynthia C. Reinhart, CPA, For Review of Action Taken By The PCAOB*, Admin. Proc. File No. 3-17758

Dear Mr. Fields:

We represent Cynthia C. Reinhart in the above-referenced application for review of action taken by the Public Company Accounting Oversight Board (the "Board") currently pending before the Commission.[1] We write to call to the Commission's attention the recent decision by the D.C. Circuit, *Laccetti v. Securities and Exchange Commission*, 885 F.3d 724 (D.C.C. 2018), in which the court held that the Board "must allow a witness the assistance of an accounting expert when such an expert could assist counsel at an investigative interview." *Id.* at 727.[2] Because Ms. Reinhart was not afforded the opportunity to bring an accounting expert of her choosing to assist her counsel during her 14 days of investigative testimony and because such an accounting expert would have undoubtedly assisted Ms. Reinhart's counsel during these interviews, *Laccetti* provides an additional basis for vacating the Board's decision in this matter.

The Board's policy of prohibiting accounting experts from assisting counsel during Ms. Reinhart's investigative testimony significantly impeded counsel's ability to represent Ms. Reinhart and her ability to fully obtain the benefit of counsel in her defense. As the *Laccetti* court recognized, "[g]iven the extraordinary complexity of matters raised in agency investigations in this modern day, counsel trained only in the law, no matter how skillful, may on occasion be less than fully equipped to serve the client in agency proceedings." *Id.* (citing *Securities and Exchange Commission v. Whitman*, 613 F. Supp. 48, 49 (D.D.C. 1985)). The need for assistance of an accounting expert is especially salient where the agency's investigators are themselves assisted by the agency's own accountants, necessitating "some means of narrowing the gap between [the witness'] counsel's and the questioner's technical expertise." *Whitman*, 613 F. Supp. at 50. Without narrowing this gap, there is

[1] Briefing was completed in this matter on April 10, 2017, and, at the Commission's direction, supplemental briefing was completed on January 12, 2018.

[2] A copy of the *Laccetti* opinion is attached hereto for the Commission's convenience at Exhibit A.

no "veritable meaning to the witness' right to counsel" provided under the Board's rules. *Laccetti*, 885 F.3d at 727.

At no point during her 14 day testimony were Ms. Reinhart and her counsel permitted the assistance of an accounting expert, even though the Division's own internal accounting experts assisted the Division's attorneys and, indeed, questioned Ms. Reinhart at length. Due to the complex nature of the other-than-temporary impairment and going concern areas of accounting and auditing at issue in Ms. Reinhart's testimony, which became the subject of her disciplinary proceeding, Ms. Reinhart and her counsel would have benefited substantially from the assistance of an accounting expert during her testimony. In addition, the assistance of an accounting expert would have been invaluable during Ms. Reinhart's questioning about other complex topics like the proper treatment of accounting for hedging instruments under FAS 133 (*see, e.g.*, Reinhart Dep. 989:1 – 992:22 (July 1, 2009)), accounting for auction calls and auction call swaps (*see, e.g.*, Reinhart Dep. 931:10 – 932:22 (July 1, 2009), 2174:16 – 2175:3 (Jan. 13, 2010)); the proper treatment of premium amortization under FAS 91 (*see, e.g.*, Reinhart Dep. 100:19 – 101:19 (Jan. 22, 2009), 1953:2 - 16); and accounting for interest only loans (*see, e.g.*, Reinhart Dep. 151:3 – 14 (Jan. 22, 2009)); and interest only strips (*see, e.g.*, Reinhart Dep. 433:3 – 15 (January 23, 2009), 2399:1 – 16 (January 14, 2010)). In all of these areas, without the assistance of an accounting expert during the questioning, Ms. Reinhart's counsel was at a significant disadvantage during Ms. Reinhart's testimony, and Ms. Reinhart was effectively denied her right to counsel under Board Rule 5109(b).[3]

As the above demonstrates, the impact of precluding Ms. Reinhart's counsel from using the assistance of an accounting expert during her investigative testimony was substantial. A technical expert would have significantly improved her counsel's ability to ensure the fairness and reliability of the investigative process. Moreover, the Board relied heavily on Ms. Reinhart's investigative testimony in its order instituting disciplinary proceedings against her. Had Ms. Reinhart's counsel been afforded the opportunity to have the assistance of an accounting expert, counsel's understanding of the questions and the issues and ability to represent her at the hearing would have been significantly enhanced, which in turn would have enabled Ms. Reinhart to make a better record of her position in the investigative process.In which case the Board may well have chosen not to institute disciplinary proceedings against her in the first instance. The investigative proceedings were therefore fundamentally unfair and defective.

KPMG has consistently taken the position that the Board's rules in this respect were fundamentally unfair and a violation of witnesses' right to counsel. At the time the Board's rules were first promulgated, KPMG advised the Commission of its significant concern with Board Rule 5102(c)(3) and its impact on the fairness of the investigative process. As KPMG stated in its April 15, 2004 letter to the Commission, "basic fairness says that when the Board is questioning a witness whose license and livelihood could well depend on the outcome of that testimony, that witness is entitled to effective and adequate counsel, including utilization of the technical consultant expertise counsel needs to be effective." *See* Letter from KPMG to the Securities and Exchange Commission regarding the Board's Proposed Rules Relating to Investigations and Adjudications (Apr. 15, 2004), attached hereto as Exhibit B. Numerous other industry and legal stakeholders have also warned of the rule's interference with witnesses' right to counsel, including the American Bar Association, which expressed its concerns about Rule 5102(c)(3) and advised the Board of its position that

[3] Board Rule 5109(b) provides that a witness giving investigative testimony has the right to "be accompanied, represented and advised by counsel, subject to Rule 5102(c)(3)." Board Rule 5102(c)(3) states that the "[p]ersons permitted to be present at an examination" are limited to "the person being examined and his or her counsel" and "such other persons as the Board, or the staff of the Board . . . determine are appropriate to permit to be present."

"adequate representation may only be achieved by allowing legal counsel to be assisted by an accounting expert." *See* Letter from the American Bar Association to the Board, regarding Rulemaking Docket Matter No. 005 (Aug. 21, 2003), attached hereto as Exhibit C. That KPMG and Ms. Reinhart did not reiterate their position on Board Rule 5109(b) in this matter is of no consequence. It is undisputed and was widely known in the industry that the Board had a uniform and absolute practice of refusing any requests for the assistance of accounting experts during witness testimony, and it would have been futile for Ms. Reinhart to have raised this issue before the Board. Indeed, the Board's own published statements demonstrate that such a request by Ms. Reinhart would have been fruitless: in adopting Rule 5102(c)(3), the Board expressly rejected the application of *Whitman* to the Board's proceedings—erroneously, as the D.C. Circuit has now held—and directed its staff to be "vigilant about not permitting a firm's internal personnel effectively to monitor an investigation by sitting in on testimony of all firm personnel." PCAOB Release No. 2003-015 at A2-18—A-2-19.

The Commission is now in a position to cure these fundamental defects in the Board's proceedings. Because Ms. Reinhart's application for review is still pending, it is only the Commission's decision thereon—not the underlying Board orders—that will constitute final agency action on the matter. *See* 5 U.S.C. § 704; *see also Bennett v. Spear*, 520 U.S. 154, 177–78 (1997) (noting that final agency action is had only at the "consummation of the agency's decisionmaking process," where the action is one that finally determines the parties' rights and is an act "from which legal consequences will flow"). The agency's decisionmaking process is thus not yet consummated: the Commission can now vacate the Board's orders before they have the full effect of law. And in light of *Laccetti*, it is now incumbent upon the Commission do so, as affirming the sanction in the face of this defect in the investigative process would be arbitrary and capricious under the APA.

Accordingly for these reasons, in addition to all the other grounds set out in our briefing, we respectfully request that the Commission vacate the Board's underlying order and sanctions in this matter.

Sincerely,

George A. Salter

George A. Salter

cc: Phoebe Brown, Secretary
Public Company Accounting Oversight Board

EXHIBIT A

885 F.3d 724
United States Court of Appeals,
District of Columbia Circuit.

Mark E. LACCETTI, Petitioner
v.
SECURITIES AND EXCHANGE COMMISSION, Respondent.

No. 16-1368
|
Argued December 12, 2017
|
Decided March 23, 2018

Synopsis

Background: Accountant petitioned for review of an order of the Securities and Exchange Commission (SEC), which affirmed Public Company Accounting Oversight Board's decision, after investigating audit conducted by accountant's firm, to suspend accountant from profession for two years and fine him $85,000.

Holdings: The Court of Appeals, Kavanaugh, Circuit Judge, held that:

[1] Board acted arbitrarily and capriciously by barring an accounting expert from assisting accountant's counsel at interview when investigating an audit that had been conducted by accountant's firm, and

[2] Board did not commit harmless error by barring expert from assisting counsel.

Petition granted, order vacated, and matter remanded.

West Headnotes (2)

[1] **Accountants**
Discipline;suspension or revocation

Public Company Accounting Oversight Board acted arbitrarily and capriciously by barring an accounting expert from assisting accountant's counsel at interview when investigating an audit that had been conducted by accountant's firm; Board's rationale for excluding expert, that it did not want firm's personnel to be present, made no sense, as Board policy and relevant rules permitted firm's attorney to act as attorney for both accountant and firm, even if Board wanted to bar firm-affiliated expert, it would not justifying Board denying accountant any expert, and Board could not bar accountant from using expert to assist his counsel. 5 U.S.C.A. § 706; 15 U.S.C.A. § 7215(a).

Cases that cite this headnote

[2] **Accountants**
Discipline;suspension or revocation

Public Company Accounting Oversight Board did not commit harmless error by barring an accounting expert from assisting accountant's counsel at interview when investigating an audit that had been conducted by accountant's firm, thereby requiring vacation of order suspending accountant from practice of law for two years and fining him $85,000; Board's decision to institute proceedings might have been based in part upon his investigative testimony, which occurred without accounting expert present. 5 U.S.C.A. § 706; 15 U.S.C.A. § 7215(a).

Cases that cite this headnote

On Petition for Review of an Order of the Securities & Exchange Commission

Attorneys and Law Firms

Douglas R. Cox argued the cause for petitioner. With him on the briefs was Michael J. Scanlon.

Mark R. Freeman, Attorney, U.S. Department of Justice, and Lisa K. Helvin, Senior Counsel, U.S. Securities and Exchange Commission, argued the causes for respondent. With them on the brief were Mark B. Stern and Jennifer L. Utrecht, Attorneys, U.S. Department of Justice, Michael A. Conley, Solicitor, and Dominick V. Freda, Assistant General Counsel, Securities and Exchange Commission.

Before: Griffith, Kavanaugh, and Wilkins, Circuit Judges.

Opinion

Kavanaugh, Circuit Judge:

***725** The Public Company Accounting Oversight Board investigated an audit that had been conducted by the Ernst & Young accounting firm. The Board's investigation focused in part on Mark Laccetti, who was the Ernst & Young partner in charge of the audit. As part of the investigation, the Board interviewed Laccetti. During that investigative interview, the Board allowed Laccetti to be accompanied by an Ernst & Young attorney. But the Board denied Laccetti's request to also be accompanied by an accounting expert who would assist his counsel.

The Board ultimately charged Laccetti and found that he had violated Board rules and auditing standards. The Board sanctioned Laccetti, suspending him from the accounting profession for two years and fining him $85,000. The Securities and Exchange Commission affirmed the Board's decision.

Laccetti asks this Court to vacate the orders and sanctions against him. Laccetti contends that the Board infringed his right to counsel by unreasonably barring the accounting expert from assisting his counsel at the interview. We agree. We grant the petition for review, vacate the order of the Securities and Exchange Commission, and remand with directions that the Commission vacate the Board's underlying orders and sanctions.

* * *

Congress has mandated that Board investigations use "fair procedures." 15 U.S.C. § 7215(a). Implementing that statute, the Board's Rule 5109(b) provides: "Any person compelled to testify" in a PCAOB investigative interview "may be accompanied, represented and advised by counsel...." Rule 5102(c)(3) further allows the Board to limit attendance at the interview to "(i) the person being examined and his or her counsel ... and (iv) such other persons as the Board ... determine[s] are appropriate...."

Laccetti argues that the Board, in applying the rules, unlawfully barred an accounting expert from assisting Laccetti's counsel at the investigative interview. The Board stated that it denied Laccetti's request because Laccetti's expert was employed at Ernst & Young. The Board did not want Ernst & Young personnel present for the testimony of the Ernst & Young witnesses because it apparently did not want Ernst & Young personnel to monitor the investigation. That was the sole reason provided by the Board for denying Laccetti's request.

[1] The Board's rationale suffers from three independent flaws.

First, the arbitrary and capricious standard requires that an agency's action be reasonable and reasonably explained. Here, the Board's explanation for denying Laccetti's request was not reasonable.

An Ernst & Young employee was already planning to attend (and did attend) Laccetti's interview—namely, the Ernst & Young attorney who accompanied Laccetti. Consistent with Board policy and relevant ethics rules, that Ernst &Young attorney could act as attorney for both Laccetti and the company. *See* PCAOB Release No. 2003-015 at A2-19 (Sept. 29, 2003). Given the presence of the Ernst & Young attorney at the interview, the Board's rationale for excluding the Ernst & Young accounting expert—that the Board did not want Ernst & Young personnel to be present—makes no sense here. [1]

***726** In its brief and at oral argument, as in the underlying agency orders, the Board has offered no good response to this point. The Board has simply repeated again and again that it had discretion to exclude an Ernst & Young accounting expert so as to ensure that Ernst & Young personnel could not monitor the investigation. Repetition does not equal logic. The Board's explanation, even when oft repeated, is not logical given the fact that an Ernst & Young attorney attended Laccetti's investigative interview. Pressed hard on this precise point at oral argument, the Board's capable counsel ultimately could muster no response and retreated to the Board's backup argument that any error by the Board in denying Laccetti the assistance of an accounting expert at his investigative interview was harmless error. *See* Tr. of Oral Arg. at 34-36.

Second, even if the Board wanted to bar an Ernst & Young-affiliated accounting expert, that explanation would not justify the Board's denying Laccetti *any* accounting expert. Instead, the Board could have told Laccetti that he could bring to the interview an accounting expert who was not affiliated with Ernst & Young. The

Board did not do so. Rather, the Board's letter to Laccetti flatly stated that "the presence of a technical expert consultant" is "not appropriate at this time." JA 458.

The Board nonetheless now claims (and the Commission agreed) that its letter was not intended to suggest that Laccetti could not bring any accounting expert, only that he could not bring an Ernst & Young-affiliated expert. But the Board's letter said no such thing and cannot reasonably be read that way. Indeed, we know that was not the intent of the letter, because the letter informed Laccetti that, as an alternative, Laccetti and his counsel could "consult[ ] with technical experts *before or after* his testimony." *Id.* (emphasis added). Even though it provided that alternative, the Board did *not* say that Laccetti could bring another accounting expert to assist his counsel *during the interview*. By telling Laccetti that he could bring an accounting expert to consult "before or after" his testimony, did the Board somehow imply that Laccetti also could bring an accounting expert to assist his counsel during the interview? Of course not. Both on its face and when read in context, the Board's letter barred Laccetti from bringing an accounting expert who could assist counsel during the interview.

In short, the Board's rationale for excluding this particular accounting expert did not justify the Board's blanket exclusion of an accounting expert who could assist Laccetti and his counsel during the interview.

Third, even putting those points aside, the Board's rules establish that the Board could not bar Laccetti from using an accounting expert to assist his counsel in these circumstances.

In *SEC v. Whitman*, 613 F.Supp. 48 (D.D.C. 1985), a district court in this circuit addressed an almost identical question in the context of the Administrative Procedure Act. Section 555(b) of the APA states: "A person compelled to appear in person ***727** before an agency or representative thereof is entitled to be accompanied, represented, and advised by counsel or, if permitted by the agency, by other qualified representative." 5 U.S.C. § 555(b). In *Whitman*, the SEC had allowed the witness to bring an attorney, but not an accounting expert, to his interview. The *Whitman* Court ruled that the SEC had impermissibly infringed the witness's right to counsel: "Given the extraordinary complexity of matters raised in agency investigations in this modern day, counsel trained only in the law, no matter how skillful, may on occasion be less than fully equipped to serve the client in agency proceedings. Unless the lawyer can receive substantive guidance from an expert technician—in this case, an accountant—when he determines in his professional judgment that such assistance is essential, his client's absolute right to counsel during the proceedings would become substantially qualified." *Whitman*, 613 F.Supp. at 49. In this context, an expert is an "extension of" counsel and gives "veritable meaning to the witness' right to counsel." *Id.* at 50.

The Board here does not challenge *Whitman*'s analysis of the APA's right to counsel. But the Board maintains (and the Commission agreed) that *Whitman*'s analysis is not persuasive in this case because *Whitman* dealt with the APA, not with the Board's rules. The Board says that its rules are different. We disagree that the right to counsel guaranteed by the Board's rules can reasonably be read to be less than the right to counsel guaranteed in the APA. We find no meaningful distinction between the right to counsel in the APA and the right to counsel in the Board's rules. To be sure, the Board's rules grant the Board discretion to exclude "other persons" from an investigative interview as the Board deems "appropriate." But that grant of authority does not entitle the Board to infringe the right to counsel. The insight of *Whitman*—to reiterate, a case that the Board does not dispute here—is that the right to counsel in this context encompasses the right to have the assistance of an accounting expert during the interview. [2]

Under the Board's rules, the Board therefore may not bar a witness from bringing an accounting expert who could assist the witness's counsel during an investigative interview. (To prevent monitoring, the Board may exclude a company-affiliated accounting expert when no other company-affiliated personnel are allowed at the interview.) To be clear, the Board is always free to change its rules, subject to constitutional and statutory constraints. Our holding on this point is therefore exceedingly narrow. All we conclude in this case is that the Board, under its current rules, must allow a witness the assistance of an accounting expert when such an expert could assist counsel at an investigative interview. Our conclusion is especially narrow because the Board itself has long directed its staff to "permit a technical consultant to be present during investigative testimony." PCAOB Release No. 2003-15 at A2-18. So our decision on this

point means no more than that the Board must apply its rules as the Board already applies its rules. The problem is that the Board did not follow its rules in this particular case.

*728 In sum, for those three independent reasons, wee conclude that the Board acted unlawfully when it barrede Laccetti from bringing an accounting expert to assist hise counsel at the investigative interview.e

As a backup, the Board argues (and the Commission agreed) that any error in denying Laccetti's right to counsel was harmless because any error in denying the right to counsel did not affect the charging decision against Laccetti. *See* 5 U.S.C. § 706. We disagree.

In response to the Board's harmless error argument, Laccetti first contends that, in the context of a Board investigation, infringement of the right to counsel at an investigative interview is a structural defect not susceptible to harmless error analysis. Laccetti says that there is no good or meaningful way to assess whether the Board's infringement of the right to counsel at an investigative interview affected Laccetti's answers and thereby tainted the Board's later decisions to bring charges and find liability.

[2]e We need not consider the question of whether this kinde of error is a structural error not susceptible to harmlesse error analysis. Even if the effect of such an error can bee meaningfully assessed such that the denial of counsel weree subject to harmless error analysis, the Commission itselfe conceded in this case that the Board's "decision to institutee proceedings" against Laccetti "may have been based in part upon his investigative testimony," which occurred without the accounting expert present. *In the Matter of the Application of Mark E. Laccetti, CPA For Review of Disciplinary Action Taken by the PCAOB*, Exchange Act Release No. 78764, 2016 WL 4582401, at *15 (Sept. 2, 2016). The Board's infringement of Laccetti's right to counsel was not harmless in this case.

Therefore, the only reasonable remedy is for the Board, if it chooses and if the law otherwise permits, to open a new disciplinary proceeding against Laccetti and, if it chooses to re-interview Laccetti, to do so without violating his right to counsel. The right to counsel is guaranteed by the Board's rules. Infringement of that right is a serious matter. We cannot sweep that violation under the rug in the manner advocated by the Board in this case.

* * *

We grant the petition for review, vacate the order of the Securities and Exchange Commission, and remand with directions that the Commission vacate the Board's underlying orders and sanctions. In light of our judgment, we need not and do not reach Laccetti's broader constitutional and statutory challenges.

So ordered.

All Citations

885 F.3d 724

Footnotes

1 This is not a case where the Board sought to exclude all company-affiliated personnel from the interview on the ground that Laccetti wished to keep his testimony confidential from the company and there was a legitimate concern that company-affiliated personnel either could not or would not comply with Laccetti's request. *See, e.g.*, D.C. Bar Ass'n, Ethics Op. 296, Joint Representation: Confidentiality of Information (a client whose attorney represents someone else in the same matter must provide informed consent before attorney may disclose client's confidences to the co-client). Perhaps the Board could do that in an appropriate case if it wished. But we need not consider that hypothetical in this case because that is not what the Board did here. This is also not a case where the Board identified some specific reason why the company-affiliated accounting expert could not be present even if the company-affiliated attorney could be present. We do not suggest that such a distinction could never be drawn. But the Board did not do so in this case.

2 If the Board in the future wants to argue that *Whitman* was wrongly decided, we can consider that argument. But the Board has not advanced such an argument in this case. On the contrary, at oral argument, the Board's counsel was specifically asked about *Whitman*, and the Board's counsel did not say that *Whitman* was wrongly decided or that the Court should consider that question here. *See* Tr. of Oral Arg. at 37. Rather, counsel simply argued that the right to counsel in the APA was broader than the right to counsel in the Board's rules.

EXHIBIT B

April 15, 2004

Office of the Secretary
United States Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609

Re: Securities and Exchange Commission (Release No. 34-49454; File No. PCAOB-2003-07); Public Company Accounting Oversight Board; Notice of Filing of Proposed Rules Relating to Investigations and Adjudications

Dear Mr. Secretary:

KPMG LLP is pleased to respond to the request for comments from the United States Securities and Exchange Commission (the "Commission" or "SEC") regarding the filing by the Public Company Accounting Oversight Board ("PCAOB" or "Board") of its Proposed Rules Relating to Investigations and Adjudications. We appreciated the opportunity to submit comments on the Board's initial proposed rules on August 18, 2003, as well as the Board's thoughtful consideration of those comments. However, we have a significant concern regarding the fairness of the investigatory process we strongly believe merits consideration by the Commission in issuing the final rule.

Specifically, Board Rule 5102 (c) (3) imposes restrictions on who may be present during an examination of a witness under Rule 5102. Under that section, such persons are limited to the person being examined and his or her counsel; any Board member or member of the staff of the Board; the reporter; and such other persons as the Board or the staff of the Board designated in the order of formal investigation determine are appropriate to permit to be present. We believe the rule may be unduly restrictive as written insofar as it may prohibit counsel for the witness from being accompanied by a technical expert consultant. Certainly it is so if, as apparently interpreted by the Board, the rule prohibits any such technical expert consultant from being a partner or employee of the firm with which the witness is associated.

The Section by Section Analysis to the rules included as Appendix 2 to Release No. 34-49454, page A2-18, notes that several commentators suggested that the rules allow a witness and his or her counsel to be accompanied by a technical expert consultant during testimony as a matter of right—a right that has long been recognized in practice by the staff of the Commission and upheld by the Second Circuit in S.E.C. v. Whitman, 613 F. Supp.48 (D.D.C. 1985). The PCAOB has declined to modify the rule expressly to permit attendance by a technical consultant as of right, stating it need not do so because the rule "provides sufficient flexibility for the staff to permit a technical consultant to be present." The right to be properly represented, however, should not be the

subject of the staff's discretion. This is particularly true as the PCAOB strongly suggests that in the exercise of such discretion, a consultant will be "approved" only if "the consultant not be a partner or employee of the firm with which the witness is associated." We strongly urge the Commission to reconsider that position.

First, as Whitman notes, given the "extraordinary complexity" of matters raised in SEC investigations—the same types of matters that will typically be the focus of PCAOB testimony--counsel, in order to fully and adequately represent his client, may require the expertise of a technical advisor by his side. Not allowing counsel to receive substantive guidance from an expert technician when counsel has determined, in his professional judgment, that such guidance is essential to his ability to represent his client, substantially compromises the client's right to counsel in SEC testimony, according to Whitman. While the PCAOB may argue that the Administrative Procedure Act is not applicable to Board proceedings—which we do not concede—basic fairness says that when the Board is questioning a witness whose license and livelihood could well depend on the outcome of that testimony, that witness is entitled to effective and adequate counsel, including utilization of the technical consultant expertise counsel needs to be effective.[1] That is particularly the case where it is likely, if the SEC model is followed, that much of the questioning at the examination will in fact be done by, or at the least questions provided by, the PCAOB technical expert consultants who will undoubtedly be accompanying the PCAOB attorney to the examination.

Second, experience with SEC examinations suggests that the presence of such technical expert consultants at testimony can in fact lead to a much more productive exam and a clearer investigative record. Given that such persons "talk the same language" as the SEC's technical consultants, misunderstandings, ambiguities and unnecessary detours can be and frequently are avoided.

Third, there does not appear to be any logical reason to exclude technical expert consultants from the firm with which the witness is associated. KPMG, like other major accounting firms, has a dedicated staff of experienced audit partners who work solely for its Office of General Counsel to assist both in-house and external counsel who represent KPMG personnel and the firm with technical issues, and who have routinely attended SEC examinations of witnesses for thirty years. In addition to technical expertise in auditing and accounting, such persons have a close knowledge of the firm's own policies and procedures, which will likely be implicated in most PCAOB examinations. Should the Board adopt the practice suggested by the commentary to the rule, the result would be the banning of this internal technical resource. Each firm or witness then would be required to retain outside experts, leading not only to substantial costs but to inevitable delay as the outside expert would need time to familiarize him or herself with the firm's

[1] Rule 5108 expressly authorizes the Board to provide investigatory information, including testimony, to the Commission and, in the discretion of the Board, to other federal and state regulators

internal guidance. The rule would not only be unfair, but would be counterproductive to the PCAOB's goals.

The Section by Section Analysis, Page A2-19, suggests that a firm's "internal personnel" –i.e., the internal technical expert consultant--should not be permitted to "monitor" an investigation by sitting in on all testimony of firm personnel, a statement we find puzzling. The firm's in-house counsel—also members or employees of the firm—will, as they do today with the SEC, routinely attend such testimony for the purpose of protecting the rights of the witnesses and the firm. And surely any outside counsel and outside technical experts will, consistent with their ethical obligations generally, report to their clients what goes on in each examination. If a witness or a firm may, as a result of an investigation, become the subject of a disciplinary proceeding, surely it is not inappropriate that they in fact educate themselves as to what the testimony of firm personnel is. Excluding internal consultants would seem to serve no purpose other than to make the investigatory process far more cumbersome and expensive, and we strongly urge the Commission to reconsider that position in issuing the final rule.

If you have questions regarding this issue, please contact Michael J. Baum, (212) 909-5604, mjbaum@kpmg.com.

Very truly yours,

KPMG LLP

EXHIBIT C

AMERICAN BAR ASSOCIATION
Section of Business Law
750 North Lake Shore Drive
Chicago, IL 60611

August 21, 2003

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

Re: Rulemaking Docket Matter No. 005

Ladies & Gentlemen:

On behalf of the Committees on Law & Accounting and Federal Regulation of Securities of the Section of Business Law of the American Bar Association (the "Committees"), we are writing to express our views with respect to the Release No. 2003-012 of the Public Company Accounting Oversight Board (the "Board" or "PCAOB") in which the Board has proposed rules for the conduct of investigations and hearings. The views expressed herein are those of the Committees and have not been approved by the Section of Business Law or the House of Delegates or Board of Governors of the American Bar Association ("ABA"). Accordingly, they should not be construed as representing the policy of the ABA. This letter was drafted by a task force composed of members of the Committees whose names are set forth below, and the Committee Chairs and members of the task force are available to discuss the matters discussed herein with the Board and its staff.

General Comments

We would like to begin our comments by commending the Board and its staff for assembling a comprehensive and generally well-conceived set of rules for the conduct of investigations and hearings in the very limited period necessitated by the timetable prescribed by Congress in the Sarbanes-Oxley Act of 2002 (the "Act"). The proposed rules generally reflect a careful balancing of the need to protect the public and the rights of accounting practitioners whose lives and livelihoods will be greatly affected by the Board's actions arising out of its investigations and disciplinary hearings.

We appreciate that (a) the Board is acting on time constraints imposed by Congress in the Act, (b) many of its proposed rules are closely modeled after the Rules of Practice of the Securities and Exchange Commission (the "Commission" or "SEC"), and (c) those wishing to comment on the Board's proposals will have an additional opportunity to do so when they are again released for public comment by the Commission. Nevertheless, in view of the length and complexity of the proposed rules, their importance to the members of the accounting profession who audit public companies as well as to issuers, and the Board's simultaneous publication of proposed rules relating to firm inspections and firm withdrawals from registration, a three-week

comment period has not provided sufficient time for a thorough review and discussion of the proposal by our members.

Because of the severe time constraints imposed by the limited comment period, our comments are largely focused on the issues that are addressed in the proposed rules. We have not had a full opportunity to consider those matters which might have been included in the proposed rules but have been omitted either by design or oversight.

For the sake of simplicity and ease of review, we have organized our comments based upon the order in which the subjects are addressed in the proposed rules, and not on the basis of their relative importance. Many of our comments are addressed to minor matters; we have proceeded on the basis that now is the appropriate time to correct minor mistakes.

Specific Comments

Rule 1001(h)(i). This rule includes within the definition of "hearing officer" one or more members of the Board so long as they constitute less than a quorum of the Board. We question the wisdom of having Board members serve as hearing officers as we do not believe that this would be a good use of their time, especially since hearings often can consume many full days. More importantly, serving as a hearing officer would disqualify any such Board member from reviewing the findings of the hearing officer, posing the potential problem of obtaining a quorum of Board members to consider an appeal from a ruling of the hearing officer. It should also be pointed out that under Rule 5200(b) hearing officers are appointed by the Secretary and it seems wholly inappropriate for the Secretary to have the power to appoint a member of the Board.

We are also concerned that the rule proposal would allow "any other person duly authorized by the Board" to serve as a hearing officer. There clearly are certain attributes that a hearing officer must have – lack of bias, judicial temperament, an understanding of relevant regulatory requirements, and so on. We would urge the Board to establish hearing officer positions within the Board staff, much like the role served by the SEC's Administrative Law Judges. These professional hearing officers would have the necessary attributes so that the public and the profession can have full confidence in the integrity of the administrative process.

Rules 5102(b)(3) and 5105(a)(1). These provisions require that the Board's staff include a description of the subject matter of the testimony in a demand for testimony only in the case of testimony of a "registered public accounting firm." We see no reason why the requirement for the subject matter of the testimony should not also apply to demands served on persons associated with a registered public accounting firm. This appears to be a drafting oversight.

Rule 5102(c)(3). This rule limits the persons allowed to be present during the taking of investigative testimony and provides that the witness may only be represented by legal counsel. Since the subject matter of the Board's investigations are likely to involve technical accounting issues, as to which legal counsel may lack appropriate understanding, we believe that adequate representation may only be achieved by allowing legal counsel to be assisted by an accounting expert.

Rule 5102(e). This rule requires a witness to request changes to the transcript of his or her testimony given in a Board investigation within 10 days of being notified that the transcript is available. This seems to be an unnecessarily short period of time, and we recommend that the period be extended to at least 30 days.

Rule 5105(a)(2). In referring to the individual to be examined on behalf of a person that is an entity, this rule refers to the designated individual as a "person." This implies that an entity can designate another entity to testify on its behalf. We suggest that the "designated person" be referred to as an "individual."

Rule 5106. This rule addresses the assertion of privilege in an investigatory proceeding and requires the respondent to provide a host of information in order to assert a privilege. Some of that information will not always be readily available. We, therefore, believe that a certain amount of flexibility must be drafted into this provision. We also are concerned that the failure to provide the required information would place the respondent in the uncomfortable position of either having to waive a privilege or risk being cited for non-cooperation with the Board's investigation.

Rule 5109(a). This rule permits the Director of Enforcement and Investigations to honor a respondent's requests for a copy of a formal order of investigation. We strongly believe that respondents should have this right and believe that it should not be a matter of discretion. If necessary, the Board's rules should require the requesting party to agree to certain limitations upon his or her use of the order.

Rule 5109(d). This rule affords a respondent in an investigation the opportunity to submit a "statement of position" to the Board in defense of his or her actions which are the subject of a possible request by the staff to initiate a disciplinary proceeding. Such a statement corresponds to a "Wells submission" in an SEC investigation. The rule, however, provides the staff with "discretion" as to whether it wishes to advise the respondent of the nature of its proposed allegations. We believe that such discretion defeats the purpose of a procedure that in SEC administrative practice has proven helpful in focusing the issues in dispute. Accordingly, we recommend that the staff not only be required to provide the respondent with information concerning its proposed charges, but also that the information identify all professional and regulatory provisions alleged to have been violated as well as the specific actions of the respondent that are the basis for the allegations.

Rule 5110. This provision authorizes the Director of Enforcement and Investigations to recommend to the Board that a disciplinary proceeding be instituted where a firm or associated person may have given false or misleading testimony or testimony that omits material information. We are troubled by this standard as we strongly believe that in any such circumstances the burden should be on the Board to establish that the question that was not properly addressed specifically requested the omitted information and that the omission was not inadvertent.

Rule 5200(a)(2). Under this provision, the Board has the power to commence a disciplinary proceeding against "supervisory personnel" for having failed to supervise an

associated person. Unfortunately, the term "supervisory personnel" is not defined in the Act or in the Board's rules and conceivably could cover a senior accountant performing field work with junior accountants. We recognize that in any audit engagement, there is a chain of command; however, we do not believe that all persons within that chain properly could be viewed as "supervisory personnel." Instead, we would limit supervisory responsibility to the partner in charge of the audit and the audit manager. Concurring partners, engagement partners and review partners, while fulfilling important roles, should not be burdened with supervisory responsibility. Similarly, we have concerns as to what constitutes a failure of "reasonable supervision." We believe that it will be necessary for the Board to spell out this new requirement in its rules because we are not aware of any body of professional literature discussing it.

Rule 5200(b). This rule enumerates the powers of the hearing officer. Absent from the list of such powers are the powers to resolve disputes relating to documentary disclosures. We also suggest the inclusion of an additional power to perform all other duties authorized elsewhere in the rules.

Rule 5201(a). The rule, which provides for notice of the commencement of a disciplinary proceeding, is silent as to the amount of notice that is required before the first hearing date. Considering the fact that the respondent will only have access to the investigatory files accumulated by the staff after the order initiated the hearing has been issued, hearings should not be permitted to commence until at least ninety days after such notice so as to provide the respondent a reasonable time in which to prepare his or her defense.

Rule 5201(b). This rule, which specifies the content of an order instituting proceedings, does not provide that the order would set the hearing date with respect to disciplinary proceedings under Rules 5200(a)(1) and (a)(2) but would set the hearing date with respect to proceedings pursuant to Rule 5200(a)(3). This may have been an oversight, or it may have been intended that the hearing officer would be given the power to set hearing dates, which would perhaps be a more logical means of setting hearings dates. We note, however, that in the list of powers provided to hearing officers in Rule 5200(b) no reference is made to the power to set hearing dates.

Rule 5204(a). In the third from last line the final "e" should be deleted from the word "therefore."

Rule 5301(a). In the note following this rule, it is stated that a person who is barred or suspended from being associated with a registered public accounting firm "may not in connection with the preparation or issuance of any audit report, (i) share in the profits of, or receive compensation in any other form from, any registered accounting firm, or (ii) participate as agent on behalf of such firm in any activity of that firm." This note is confusing in view of the fact that the Board or the Commission has the power to consent to the individual's continued employment by the firm. If a partner of a registered firm is barred, does that mean that the firm cannot return the partner's capital or pay that partner a separation payment as provided in the firm's partnership agreement? Similarly, if the barred employee is allowed to remain with the firm so long as he does not become involved with public company clients, may the firm pay him

or her a salary or other compensation not related to the firm's public company practice? We believe that the rules must address such questions.

Rule 5302. This rule provides that a person who has been subjected to a Board sanction may apply for the termination of "any continuing sanction" and the applicant may, in the Board's discretion, be afforded a hearing. While we believe that this is altogether appropriate, there are no provisions in the rules governing any such hearings. This appears to be an oversight.

Moreover, the form of petition for termination of ongoing sanctions imposes upon the applicant the burden of providing information that may not be readily available to him, such as the disciplinary history of other persons associated with the same registered public accounting firm. Such information is probably more readily available to the Board and is not particularly relevant to whether the individual may safely be employed by the firm.

Rule 5401(b). As noted earlier in this letter, we believe that fair representation of a respondent in a disciplinary hearing may require respondent's counsel to be assisted by an accounting expert. Although we assume that this provision was not intended to negate that possibility, we believe the Board should make this point explicitly.

Rule 5401(c). This rule raises the question of what is "practice before the Board" and the Board's power to regulate such persons, a subject which is not addressed in these rules. This has proven to be a troublesome issue in practice before the Commission, and we believe that it should be addressed in the Board's rules, although not necessarily in its rules relating to investigations and disciplinary proceedings.

This rule also raises the question of when an individual acting in a representative capacity may withdraw from a Board proceeding. We suggest that the rule be revised to provide that the Board, at the very least, may not unreasonably withhold its permission for such an individual to withdraw. We also have concerns that it may have the effect of requiring a respondent to continue with a legal representative in whom he has lost confidence. Thus, any request by the represented party should be honored in all cases.

Rule 5402(a). Under this rule, a motion for a hearing officer to recuse himself or herself is to be addressed to the hearing officer in the first instance. Such motions should be subject to an interlocutory appeal, with the Board having an offsetting power to impose fines for appeals that are deemed to be frivolous.

Rule 5402(b). When a replacement hearing officer has been appointed, we believe that the parties should have the right to move that certain testimony be reheard so that the replacement hearing officer can better judge the credibility of the witness. We do not disagree that the decision as to whether such rehearing is necessary should remain with the new hearing officer, whose decision thereon would be subject to Board review.

Rule 5408. The time and page limitations relating to motions appear to be unduly restrictive and assume that all motions to be presented to a hearing officer will be of a discreet nature. Moreover, whereas the hearing officer has the power to expand the page limitation, there

is no corresponding power with respect to extending the response period. We presume that this is an oversight.

Rule 5422. This rule specifies the documents that the staff must make available to the respondents. Although the scope of the documents required to be disclosed appears to be appropriate, there is no specification as to when the disclosure is to take place or how the copying is to be effected. Similarly, while subsection (e) specifies that the copying is to be at the respondent's expense, there is no attempt to state what the cost would be if the copying is to be effected by the Board. Does this mean that the respondent has the right to select a copying service to make the copies?

Rule 5424(a)(4). This rule provides that a non-party witness who is summoned to a hearing or deposition shall be reimbursed for his or her "reasonable expenses." Who is to make this determination and what are the criteria of "reasonableness." Does "expense" include hourly wages or charges?

Rule 5425(a). This rule would appear to limit the use of depositions solely to preserve testimony and not for discovery purposes. This places the respondent at a distinct disadvantage as the staff has virtually unlimited power to take testimony during the discovery period. Thus, the respondent is forced to ask questions of a witness at his peril during the hearing, not knowing in advance how the witness will testify. Under such circumstances, respondents might be reluctant to pursue questions that could be beneficial to their position. Moreover, it is not even clear when such a deposition can be taken as the rules do not address the criteria to be used by the hearing officer in setting the dates of the hearings. We, therefore, believe that in view of the dire consequences that could befall a professional in a Board disciplinary hearing, the rules should provide for discovery beyond that provided by the staff.

Rule 5425(d). This provision, which relates to the conduct of depositions, refers to a "deposition officer." Unfortunately, the rules do not address the qualifications or appointment or duties of this individual. We presume that this is simply an oversight.

Rule 5441. In our view, this section highlights the brevity in the proposed rules of any description of evidentiary rules that might apply to a Board hearing. Although it is explained in the "section-by-section analysis" that this is intended to afford the hearing officer flexibility in conducting the hearing, such flexibility does little to assure uniformity of practice or fairness when the hearing officer is employed by the prosecuting agency. Moreover, the criteria for excluding evidence does not include the prejudicial nature of the evidence, its competence or authenticity. While, as lawyers, we appreciate the potential complexity of evidentiary rules, we are concerned that the broad range of discretion provided to the hearing officer is inappropriate in disciplinary proceedings which have the power to preclude a professional from being able to continue practicing which is being decided by an employee of the Board. We, therefore, urge the Board to adopt greater structure for evidentiary rulings.

Other Comments

Missing from the proposed rules is a statement as to who has the burden of proof in a disciplinary hearing and the degree of that burden (i.e., "by a preponderance of the evidence", etc.). Under what circumstances would the burden shift?

It is also not clear what standard can be the basis of a disciplinary proceeding. For example, can a registered person be subjected to a disciplinary proceeding for a single act of negligence? This was an issue faced by the Commission in the *Checkosky* decisions, and it behooves the Board to address this issue and avoid protracted litigation on the subject. Sanctions are discussed in Rule 5300 which is silent on this point.

We hope that these comments will be of assistance in finalizing its rules with respect to the conduct of investigations and hearings. Members of our committees are available to discuss these and other comments. If you believe that such discussions would be helpful, please contact either of the undersigned.

Respectfully submitted,

Committee on Law & Accounting

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