



Ernst & Young LLP
5 Times Square
New York, New York 10036

Phone: (212) 773-3000
www.ey.com

VIA ELECTRONIC FILING

April 15, 2004

Mr. Jonathan G. Katz, Secretary
United States Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Release No. 34-49454; File No. PCAOB-2003-07, PCAOB Rules on Investigations and Adjudications

Dear Mr. Katz:

Ernst & Young LLP (“Ernst & Young”) is pleased to submit comments on the Rules adopted by the Public Company Accounting Oversight Board (“Board” or “PCAOB”) establishing procedures for the investigation and discipline of registered public accounting firms and associated persons of such firms.

We, along with other interested persons, submitted comments during the Board’s consideration of its proposed rules. We are pleased that the Board made a number of changes to reflect our comments and those of other commentators. We believe that, in most respects, the Board’s Rules will provide fair and reasonable mechanisms for investigating potential violations of relevant laws and regulations and will allow the Board to carry out its statutory mandate. As Ernst & Young has stated in previous PCAOB/SEC rulemakings and in other forums, it is essential that the PCAOB establish effective and fair enforcement procedures in order to help re-establish public trust in the accounting profession.

Most of the proposed rules were adapted from similar rules of the Securities and Exchange Commission (“SEC”) or the National Association of Securities Dealers. Those organizations have decades of experience with investigations and adjudications. Their procedures provide an appropriate model for the PCAOB’s rulemaking.

Because of the changes made by the Board during the comment process, we have only limited comments on the Rules, and we support the SEC’s issuance of an order approving them. However, our one principal comment, discussed below, involves a matter of significant concern to us. We urge that the Commission in its approval order give the PCAOB guidance as to how it might address this concern.

1. Rules 5102 (Testimony of Registered Public Accounting Firms and Associated Persons in Investigations) and 5109 (Rights of Witnesses in Inquiries and Investigations).

Rules 5102 and 5109 address, among other matters, the right to counsel in Board investigations. Subparagraph 5102(c)(3) identifies persons who are permitted to be present when the Board staff takes investigative testimony. It allows the person being examined to be represented by legal counsel, as does Rule 5109(b). Rule 5102(c)(3) also states that the Board will allow “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; provided, however, that in no event shall a person other than the witness who has been or is reasonably likely to be examined in the investigation be present.” (emphasis in original). Thus, although the Board or its staff might determine it “appropriate” to allow other persons also to be present during testimony, it suggests that the normal course might be not to do so.

Our comments on the PCAOB’s rule proposal, as well as the comments submitted by many others, expressed concerns about this restrictive language because it would mean that lawyers representing accountants during testimony would likely not have the assistance of accounting experts in a consulting capacity. Counsel’s access to expert assistance during testimony is a significant aspect of the right to effective counsel. As the court observed in *SEC v. Whitman*, 613 F. Supp. 48 (D.D.C. 1985), “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.* at 49. Our firm has consistently relied on in-house experts to assist inside and outside counsel in Commission investigations, without objection. Often the consultant’s technical knowledge of accounting matters also helps to produce a more accurate and complete investigative record.

The Board, in its Section-by-Section discussion of the Rules, stated that it rejected these concerns. It dismissed the relevance of *Whitman* on the ground that it “rests on the requirements of the Administrative Procedure Act, which is not applicable to Board proceedings.” PCAOB Release No. 2003-015 at A2-19 n.1 (September 29, 2003) (“PCAOB Release”). But that misses the significance of *Whitman*. The court there was concerned with the fundamental unfairness, not with the technical APA requirements, of prohibiting a witness’ counsel from having access to technical knowledge and assistance during the witness’ testimony.

Further, the Board stated in its Section-by-Section analysis of the Rules that “[t]he rule provides sufficient flexibility for the staff to permit a technical consultant to be present during investigative testimony, and we expect the staff to allow that presence in appropriate circumstances and on appropriate terms, including, for example, that the consultant not be a partner or employee of the firm with which the witness is associated.” PCAOB Release at A2-18. This commentary exacerbates our concern.

At Ernst & Young, we have more than a dozen accountants, all of whom are partners or principals of the firm, who are assigned full-time to the firm’s Office of the General Counsel. These accountants assist the firm’s in-house attorneys and/or outside counsel in connection with alleged professional misconduct. When there is an allegation or discovery of a possible audit failure, they are tasked with finding out what happened. Under the supervision of counsel, they

review workpapers, meet with relevant staff, and perform other investigative activities. They do so quickly and effectively. We believe strongly that their involvement helps our firm better understand the facts and circumstances relating to events that may be the subject of litigation or of regulatory investigation. In certain cases, their internal investigation may lead the firm to take remedial measures relating to audit personnel. In other cases, because of their intimate familiarity with the firm and its procedures, they may identify areas for improvement that cause the firm to revise its audit policies and procedures.

Because of their knowledge, these accountants also help counsel in representing witnesses during private or governmental inquiries. We should not be deprived of this in-house expertise merely because an in-house forensic accountant is also “a partner or employee of the firm with which the witness is associated.” Nor should we be required to hire accountants from another accounting firm, who would then duplicate the efforts of the General Counsel Office’s team of forensic accountants, in order to ensure that witnesses receive adequate representation during PCAOB investigations.

We respectfully submit that the proposed restriction would lack any rational basis. The Board states only one concern: that the presence of a partner or employee of a firm would permit a firm “effectively to monitor an investigation by sitting in on testimony of all firm personnel.” PCAOB Release at A2-18-19. But the Rules do not preclude either in-house or outside *counsel* from representing multiple witnesses, as long as counsel state that they represent the witness at the testimony. *See* Rule 5109(b). Indeed, joint representations – as well as joint defense agreements among several counsel and clients – are entirely ethical and are commonly recognized as appropriate in all investigative settings, notwithstanding the possibility that they conceivably present the same “monitoring” concerns. The Rules make no effort to preclude these arrangements, provided that counsel comply with their ethical obligations. Therefore, a blanket prohibition on in-house experts would not address the concern expressed in the PCAOB’s Rule Release.

To the extent that the Board is concerned about possible improper influence on witness testimony or inappropriate “monitoring,” a better solution would be for the Board to exclude in-house technical experts who have supervisory or managerial authority over the witness involved.

2. Rule 5424(b) (Commission Subpoenas).

We note that Rule 5424(b) provides that both the Board and a respondent firm or associated person may apply for a subpoena from the Commission to compel the attendance of witnesses or the production of documents in adjudications. This right, which is similar to that afforded in the Commission’s Rules of Practice, enhances the quality of the Board’s fact finding and provides an important right to respondents who may need to secure testimony from reluctant or uncooperative witnesses. The Board’s Rule, however, does not, and cannot, adopt procedures that the Commission will follow in issuing subpoenas in connection with Board proceedings, and we note that the Commission has specifically asked for comments on this issue. SEC Release No. 34-49454 at n.7.

We propose that the Commission consider rules setting procedures for issuing subpoenas in Board adjudications, both when requested by the Board pursuant to Rule 5424(b) and when

requested directly by a respondent in Board proceedings in situations where the Board itself has declined to seek a Commission subpoena on the respondent's behalf. While there are several alternatives, we believe the most appropriate and efficient procedure would require that requests for a subpoena be made to the Commission's Chief Administrative Law Judge. This officer is designated to issue subpoenas under the Commission's Rules of Practice in the absence of the presiding hearing officer in Commission proceedings. *See* 17 C.F.R. § 201.232. The Chief Administrative Law Judge would be familiar with the evidentiary standards likely to be at issue in Board procedures and could resolve any issue concerning the appropriateness of the issuing process.

* * *

We appreciate the opportunity to provide these comments, and we would welcome discussion of any points that require further explanation.

Respectfully submitted,

A handwritten signature in black ink that reads "Ernst & Young LLP". The signature is written in a cursive, flowing style.

Ernst & Young LLP