



**VIA ELECTRONIC FILING**

May 17, 2004

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

**Re: Public Company Accounting Oversight Board; Notice of Filing of Proposed Rule and Form Relating to Inspections of Registered Public Accounting Firms, SEC Release No. 34-49579, File No. PCAOB-2004-08**

Dear Mr. Katz:

Ernst & Young LLP (“Ernst & Young”) is pleased to submit comments on the Rules adopted by the Public Company Accounting Oversight Board (“PCAOB”) for the inspection of accounting firms registered with the PCAOB.

We submitted comments to the PCAOB during its rulemaking process. The PCAOB amended several aspects of its proposal in response to our comments and those of others. Accordingly, our comments are limited to two areas where we still have significant concerns.

1. Rule 4004 provides that if the Board’s staff obtains information during an inspection that a registered firm or its associated persons “may have engaged, or may be engaged, in any act, practice, or omission to act that is or may be in violation of the Act, the rules of the Board, any statute or rule administered by the Commission, the firm’s own quality control policies, or any professional standard,” then the Board “shall, if it determines appropriate,” report the information to the Commission and appropriate state regulators.

We are concerned about the breadth of this Rule and the absence of any standard for when such a referral would be made. This is particularly so because the Board did not adopt our suggestion that the PCAOB notify the affected firm when it intends to make such a referral so as to provide the firm with an opportunity to be heard on the matter.

We do not believe that the Commission or state regulators should (or would want to) receive information about every possible violation that might be uncovered during an inspection. As the Commission knows from its own inspections of regulated entities such as broker-dealers and investment advisers, relatively minor or technical rule violations are routinely found during inspections. The PCAOB staff almost certainly will have the same experience. The Rule, however, requires that the Board make a determination whether to refer such violations to the Commission or state regulators for further action. And, although we are confident that the PCAOB will exercise sound judgment, it seems likely that, to avoid being second-guessed as to why a particular violation or violations was not referred, the PCAOB will err on the side of making many such referrals. This will doubtlessly burden the SEC's staff, which will presumably find it necessary to investigate all such referrals.

The PCAOB responded to the concerns of numerous commenters about Rule 4004 by stating, "The rule tracks Section 104(c) of the Act, which is itself a directive to the Board, and the Board does not consider it appropriate to change the threshold for reporting set forth by Congress in the Act." PCAOB Release No. 2003-019, page A2-10. But, of course, Congress provided the PCAOB with rulemaking powers specifically in order to refine its broad statutory powers.

In our view, the Rule should include some type of qualitative standard for referrals. It should, for example, be amended to restrict referrals to "significant" violations, or violations that "are reasonably likely to cause harm to the investing public," or violations that reflect a

“significant departure” from applicable rules or standards. Other, similar formulations of a standard could be developed.

2. Rules 4007 and 4008 set forth the procedures concerning draft and final inspection reports. Rule 4007(a) states that the PCAOB staff will provide a draft inspection report to an inspected firm, which is allowed to make a written response. Under Rule 4007(c), the Board may then take any action it considers appropriate, including “adopting the draft report as the final report, revising the draft report, or continuing or supplementing the inspection before issuing a final report.” Further, to the extent the draft report is revised, “the Board may, in its discretion, afford the firm the opportunity to review any revised draft inspection report.” Rule 4008(b)-(c) provides that the Board will transmit the final report to the Commission and, in appropriate detail, to state regulatory authorities along with “any additional letter or comments by the Board or the Board’s inspectors that the Board deems appropriate.”

We are concerned that the end result of these two rules is that the Board may transmit a final inspection report containing statements as to which the inspected firm has not had the opportunity to submit written comments. Under Rule 4007, the Board might change the report substantively from the draft to final. Under 4008, the Board might include substantive comments in the transmittal letter. Through either means, the inspected firm might not have the opportunity to provide the substantive input that is clearly required by Section 104(g)(1) of the Sarbanes-Oxley Act, which states that the Board must transmit the final report “in appropriate detail, to the Commission and each appropriate State regulatory authority, accompanied by any letter or comments by the Board or the inspector, and any letter of response from the registered public accounting firm.” Thus, the Act requires that the inspected firm have the opportunity to submit a “letter of response” on the final report as sent to the Commission and state regulators. Accordingly, if the Board makes substantive changes in the final report after showing the

inspected firm a draft report, or if the Board makes substantive comments in a transmittal letter, the inspected firm should be given the opportunity to submit written comments.

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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