Room 10230, New Executive Office Building, Washington, D.C. 20503.

Charles Mierzwa,

Clearance Officer.

[FR Doc. E6–3476 Filed 3–10–06; 8:45 am]

BILLING CODE 7905–01–P

SECURITIES AND EXCHANGE COMMISSION

Sunshine Act Meeting Notice

FEDERAL REGISTER CITATION OF PREVIOUS ANNOUNCEMENT: [71 FR 11249, March 6, 2006].

STATUS: Closed Meeting.

PLACE: 100 F Street, NW., Washington, DC.

DATE AND TIME OF PREVIOUSLY ANNOUNCED MEETING: Thursday, March 9, 2006 at 2 p.m.

CHANGE IN THE MEETING: Deletion of Item.

The following item will not be considered during the Closed Meeting on March 9, 2006: Consideration of amicus participation.

The Commission determined that no earlier notice thereof was possible.

At times, changes in Commission priorities require alterations in the scheduling of meeting items. For further information and to ascertain what, if any, matters have been added, deleted or postponed, please contact the Office of the Secretary at (202) 551–5400.

Dated: March 9, 2006.

J. Lynn Taylor,

Assistant Secretary.

[FR Doc. 06–2457 Filed 3–9–06; 3:54 pm]

BILLING CODE 8010–01–P

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–53427; File No. PCAOB–2006–01]

Public Company Accounting Oversight Board; Notice of Filing of Proposed Ethics and Independence Rules Concerning Independence, Tax Services, and Contingent Fees

March 7, 2006.

Pursuant to Section 107(b) of the Sarbanes-Oxley Act of 2002 (the ''Act''), notice is hereby given that on August 2, 2005, the Public Company Accounting Oversight Board (the ''Board'' or the ''PCAOB'') filed with the Securities and Exchange Commission (the ''Commission'' or ''SEC'') the proposed rule described in Items I, and II below, which items have been prepared by the Board. On November 22, 2005, the Board adopted certain technical amendments to the rule and amended its filing on November 23, 2005. The Commission is publishing this notice to solicit comments on the proposed rule from interested persons.

I. Board's Statement of the Terms of Substance of the Proposed Rule

On July 26, 2005, the Board adopted Rules 3501—*Definitions of Terms Employed in Section 3, Part 5 of the Rules*; 3502—*Responsibility Not to Cause Violations*; 3520—*Auditor Independence*; 3521—*Contingent Fees*; 3522—*Tax Transactions*; 3523—*Tax Services for Persons in Financial Reporting Oversight Roles*; and 3524—*Audit Committee Pre-approval of Certain Tax Services* (''the proposed rules''). On November 22, 2005, the Board adopted certain technical amendments to Rule 3502, including its title, and Rule 3522. The proposed rule text is set out below.

SECTION 3. PROFESSIONAL STANDARDS—Part 5—Ethics

Rule 3501. Definitions of Terms Employed in Section 3, Part 5 of the Rules

When used in Section 3, Part 5 of the Rules, unless the context otherwise requires:

(a)(i) Affiliate of the Accounting Firm

The term ''affiliate of the accounting firm'' (or ''affiliate of the registered public accounting firm'' or ''affiliate of the firm'') includes the accounting firm's parents; subsidiaries; pension, retirement, investment or similar plans; and any associated entities of the firm, as that term is used in Rule 2–01 of the Commission's Regulation S–X, 17 CFR 210.2–01(f)(2).

(a)(ii) Affiliate of the Audit Client

The term ''affiliate of the audit client'' means—

(1) An entity that has control over the audit client, or over which the audit client has control, or which is under common control with the audit client, including the audit client's parents and subsidiaries;

(2) An entity over which the audit client has significant influence, unless the entity is not material to the audit client;

(3) An entity that has significant influence over the audit client, unless the audit client is not material to the entity; and

(4) Each entity in the investment company complex when the audit client is an entity that is part of an investment company complex.

(a)(iii) Audit and Professional Engagement Period

The term ''audit and professional engagement period'' includes both—

(1) The period covered by any financial statements being audited or reviewed (the ''audit period''); and

(2) The period of the engagement to audit or review the audit client's financial statements or to prepare a report filed with the Commission (the ''professional engagement period'')—

(A) The professional engagement period begins when the registered public accounting firm either signs an initial engagement letter (or other agreement to review or audit a client's financial statements) or begins audit, review, or attest procedures, whichever is earlier; and

(B) The professional engagement period ends when the audit client or the registered public accounting firm notifies the Commission that the client is no longer that firm's audit client.

(3) For audits of the financial statements of foreign private issuers, the ''audit and professional engagement period'' does not include periods ended prior to the first day of the last fiscal year before the foreign private issuer first filed, or was required to file, a registration statement or report with the Commission, provided there has been full compliance with home country independence standards in all prior periods covered by any registration statement or report filed with the Commission.

(a)(iv) Audit Client

The term ''audit client'' means the entity whose financial statements or other information is being audited, reviewed, or attested and any affiliates of the audit client.

(c)(i) Confidential Transaction

The term ''confidential transaction'' means—

(1) In general. A confidential transaction is a transaction that is offered to a taxpayer under conditions of confidentiality and for which the taxpayer has paid an advisor a fee.

(2) Conditions of confidentiality. A transaction is considered to be offered to a taxpayer under conditions of confidentiality if the advisor who is paid the fee places a limitation on disclosure by the taxpayer of the tax treatment or tax structure of the transaction and the limitation on disclosure protects the confidentiality of that advisor's tax strategies. A transaction is treated as confidential even if the conditions of confidentiality are not legally binding on the taxpayer.

A claim that a transaction is proprietary or exclusive is not treated as a limitation on disclosure if the advisor confirms to the taxpayer that there is no limitation on disclosure of the tax treatment or tax structure of the transaction.

(3) Determination of fee. For purposes of this definition, a fee includes all fees for a tax strategy or for services for advice (whether or not tax advice) or for the implementation of a transaction. These fees include consideration in whatever form paid, whether in cash or in kind, for services to analyze the transaction (whether or not related to the tax consequences of the transaction), for services to implement the transaction, for services to document the transaction, and for services to prepare tax returns to the extent that the fees exceed the fees customary for return preparation. For purposes of this definition, a taxpayer also is treated as paying fees to an advisor if the taxpayer knows or should know that the amount it pays will be paid indirectly to the advisor, such as through a referral fee or fee-sharing arrangement. A fee does not include amounts paid to a person, including an advisor, in that person's capacity as a party to the transaction. For example, a fee does not include reasonable charges for the use of capital or the sale or use of property.

(4) Related parties. For purposes of this definition, persons who bear a relationship to each other as described in section 267(b) or 707(b) of the Internal Revenue Code will be treated as the same person.

(c)(ii) Contingent Fee

The term ''contingent fee'' means—

(1) Except as stated in paragraph (2) below, any fee established for the sale of a product or the performance of any service pursuant to an arrangement in which no fee will be charged unless a specified finding or result is attained, or in which the amount of the fee is otherwise dependent upon the finding or result of such product or service.

(2) Solely for the purposes of this definition, a fee is not a ''contingent fee'' if the amount is fixed by courts or other public authorities and not dependent on a finding or result.

(f)(i) Financial Reporting Oversight Role

The term ''financial reporting oversight role'' means a role in which a person is in a position to or does exercise influence over the contents of the financial statements or anyone who prepares them, such as when the person is a member of the board of directors or similar management or governing body, chief executive officer, president, chief financial officer, chief operating officer, general counsel, chief accounting officer, controller, director of internal audit, director of financial reporting, treasurer, or any equivalent position.

(i)(i) Immediate Family Member

The term ''immediate family member'' means a person's spouse, spousal equivalent, and dependents.

(i)(ii) Investment Company Complex

(1) The term ''investment company complex'' includes—

(i) An investment company and its investment adviser or sponsor;

(ii) Any entity controlled by or controlling an investment adviser or sponsor in paragraph (i) of this definition, or any entity under common control with an investment adviser or sponsor in paragraph (i) of this definition if the entity—

(A) Is an investment adviser or sponsor; or

(B) Is engaged in the business of providing administrative, custodian, underwriting, or transfer agent services to any investment company, investment adviser, or sponsor; and

(iii) Any investment company or entity that would be an investment company but for the exclusions provided by section 3(c) of the Investment Company Act of 1940 (15 U.S.C. 80a–3(c)) that has an investment adviser or sponsor included in this definition by either paragraph (i) or (ii) of this definition.

(2) An investment adviser, for purposes of this definition, does not include a sub-adviser whose role is primarily portfolio management and is subcontracted with or overseen by another investment adviser.

(3) A sponsor, for purposes of this definition, is an entity that establishes a unit investment trust.

Rule 3502. Responsibility Not To Knowingly or Recklessly Contribute to Violations

A person associated with a registered public accounting firm shall not 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 that registered public accounting firm of the Act, the Rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission issued under the Act, or professional standards.

Subpart 1—Independence

Rule 3520. Auditor Independence

A registered public accounting firm and its associated persons must be independent of the firm's audit client throughout the audit and professional engagement period.

Note 1: Under Rule 3520, a registered public accounting firm or associated person's independence obligation with respect to an audit client that is an issuer encompasses not only an obligation to satisfy the independence criteria set out in the rules and standards of the PCAOB, but also an obligation to satisfy all other independence criteria applicable to the engagement, including the independence criteria set out in the rules and regulations of the Commission under the federal securities laws.

Note 2: Rule 3520 applies only to those associated persons of a registered public accounting firm required to be independent of the firm's audit client by standards, rules or regulations of the Commission or other applicable independence criteria.

Rule 3521. Contingent Fees

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.

Rule 3522. Tax Transactions

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 service to the audit client related to marketing, planning, or opining in favor of the tax treatment of, a transaction—

(a) Confidential Transactions—that is a confidential transaction; or

(b) Aggressive Tax Position Transactions—that was initially recommended, directly or indirectly, by the registered public accounting firm and a significant purpose of which is tax avoidance, unless the proposed tax treatment is at least more likely than not to be allowable under applicable tax laws.

Note 1: With respect to transactions subject to the United States tax laws, paragraph (b) of this rule includes, but is not limited to, any transaction that is a listed transaction within the meaning of 26 CFR 1.6011–4(b)(2).

Note 2: A registered public accounting firm indirectly recommends a transaction when an affiliate of the firm or another tax advisor, with which the firm has a formal agreement or other arrangement related to the promotion of such transactions, recommends engaging in the transaction.

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

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—

(a) The person is in a financial reporting oversight role at the audit client only because he or she serves as a member of the board of directors or similar management or governing body of the audit client;

(b) The person is in a financial reporting oversight role at the audit client only because of the person's relationship to an affiliate of the entity being audited—

(1) Whose financial statements are not material to the consolidated financial statements of the entity being audited; or

(2) Whose financial statements are audited by an auditor other than the firm or an associated person of the firm; or

(c) 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.

Rule 3524. Audit Committee Pre-Approval of Certain Tax Services

In connection with seeking audit committee pre-approval to perform for an audit client any permissible tax service, a registered public accounting firm shall—

(a) Describe, in writing, to the audit committee of the issuer—

(1) The scope of the service, the fee structure for the engagement, and any side letter or other amendment to the engagement letter, or any other agreement (whether oral, written, or otherwise) between the firm and the audit client, relating to the service; and

(2) Any compensation arrangement or other agreement, such as a referral agreement, a referral fee or fee-sharing arrangement, between the registered public accounting firm (or an affiliate of the firm) and any person (other than the audit client) with respect to the promoting, marketing, or recommending of a transaction covered by the service;

(b) Discuss with the audit committee of the issuer the potential effects of the services on the independence of the firm; and

(c) Document the substance of its discussion with the audit committee of the issuer.

* * * * *

II. Board's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule

In its filing with the Commission, the Board included statements concerning the purpose of, and basis for, the proposed rule and discussed any comments it received on the proposed rule. The text of these statements may be examined at the places specified in Item IV below. The Board has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Board's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule

(a) Purpose

Section 103(a) of the Act directs the Board, by rule, to establish ''ethics standards to be used by registered public accounting firms in the preparation and issuance of audit reports, as required by th[e] Act or the rules of the Commission, or as may be necessary or appropriate in the public interest or for the protection of investors.'' Moreover, 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.''

As discussed more fully in Exhibit 3, two types of tax services have raised serious concerns among investors, auditors, lawmakers, and others relating to the ethics and independence of accounting firms that provide both auditing and tax services—

1. The marketing to public company audit clients of questionable tax transactions used improperly to avoid paying taxes or to manipulate financial statements in order to make such statements appear more favorable to investors, and

2. The provision of tax services, including tax shelter products, to executives of public company audit clients who are involved in the financial reporting process at such companies.

Accordingly, the Board adopted a set of rules designed to establish a framework for addressing the concerns that have arisen in connection with auditors' provision of tax services to their public company audit clients. Specifically, the proposed rules are designed, among other things, to prevent auditors from providing (1) certain aggressive tax shelter services to public company audit clients, (2) any other service to a public company audit client for a contingent fee, which is a fee arrangement often used in tax work, and (3) any tax service to certain persons who serve in financial reporting oversight roles at a public company audit client. The rules also codify, in an ethics rule, the principle that persons associated with a registered public accounting firm should not cause the firm to violate relevant laws, rules, and standards, and introduce a foundation for the independence component of the Board's ethics rules. Finally, the rules implement the requirements of the Act and the SEC's independence rules when an auditor seeks audit committee pre-approval to provide tax services that are not prohibited by the Board's or the SEC's rules.

(b) Statutory Basis

The statutory basis for the proposed rule is Title I of the Act.

B. Board's Statement on Burden on Competition

The Board does not believe that the proposed rules will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The proposed rules would apply equally to all registered public accounting firms and their associated persons. Although some of the proposed rules would prohibit a registered public accounting firm from providing certain non-audit services to its audit clients, they would not restrict the provision of these same services to other companies.

C. Board's Statement on Comments on the Proposed Rule Received From Members, Participants or Others

The Board released the proposed rules for public comment in PCAOB Release No. 2004–015 (December 14, 2004). A copy of PCAOB Release No. 2004–015 and the comment letters received in response to the PCAOB's request for comment are available on the PCAOB's Web site at *http://www.pcaobus.org.* The Board received 807 written comments. The Board has modified certain aspects of the proposed rules in response to comments it received, as discussed below.

When the Board adopted the rules on July 26, 2005, it stated the following: [1]

[1] As discussed above, the Board adopted technical amendments to the rules on November 22,

Rule 3502—Responsibility Not to Cause Violations

Rule 3502, as proposed, provided that a person associated with a registered public accounting firm shall not cause that firm to violate the Act, the Rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission issued under the Act, or professional standards, due to an act or omission the person knew or should have known would contribute to such violation. The Board proposed the rule to codify the ethical obligation of associated persons of registered firms not to cause registered firms to commit such violations. Proposed Rule 3502 also made clear that an associated person's ethical obligation is not merely to refrain from knowingly causing a violation but also to act with sufficient care to avoid negligently causing a violation.

The Board received a number of comments on proposed Rule 3502. Several commenters supported the rule as proposed and noted that they saw the rule as essential to the Board's ability to carry out its disciplinary responsibilities under the Act. Other commenters, however, including the largest accounting firms and an accounting trade association, did not support the rule as proposed. In general, these commenters objected to the proposed rule's use of a negligence standard in light of the complex regulatory requirements with which auditors must comply. Some of these commenters also questioned the Board's authority to adopt the proposed rule, or at least the proposed rule with a negligence standard.

The Board has carefully considered these comments and determined to adopt Rule 3502, with some modifications. The Board continues to believe that it is authorized to adopt the rule. Section 103(a) of the Act directs the Board to, ''by rule, establish * * * such ethics standards to be used by registered public accounting firms in the preparation and issuance of audit reports, as required by this Act or the rules of the Commission, or as may be necessary or appropriate in the public interest or for the protection of investors.'' The Board believes that the rule is an appropriate exercise of this authority to set ethical standards for accountants subject to the Board's jurisdiction.

2005. These amendments are discussed under *The Technical Amendments*, below.

Under the Act and Board rules, both registered firms and their associated persons must comply with PCAOB rules and standards, as well as related laws. When an associated person with such a responsibility causes the firm with which he or she is associated to violate such rules, standards or laws, this conduct operates to the detriment of the protection of investors and the public interest and may bear on the ethics of the responsible associated person. When such a person engages in this conduct with knowledge that, or in reckless disregard of whether, it would directly and substantially contribute to the firm's violation, the Board believes this conduct plainly reflects an ethical lapse by the responsible person and, therefore, is within the Board's authority—and indeed responsibility—to proscribe.

At least one commenter asserted that the proposed rule was not a proper exercise of the Board's ethics standards-setting authority because it reached a range of conduct, rather than delineating ''particular impermissible conduct.'' The Board disagrees and believes the type of conduct addressed by the rule is plainly the type of conduct the Board's ethics rules can and should address. In fact, the accounting profession's existing ethical code at the time of enactment of the Act reaches any act that may ''discredit[]'' the profession—thereby reaching ranges of conduct, including violations of certain laws, rather than just specifying ''particular impermissible conduct.'' [2] When Congress vested the authority to set ethics standards in the Board, the Board believes it intended for this authority to be at least as broad as the scope of the existing ethics rules, at least as to matters within the Board's jurisdiction. This authority, in the Board's view, plainly includes the ability to require that persons subject to the Board's jurisdiction, as an ethical obligation, not cause a violation of relevant laws.

Commenters opposed to the proposed rule also sought to analogize the rule to a theory of liability that the Supreme Court rejected in *Central Bank of Denver, N.A.* v. *First Interstate Bank of Denver, N.A.*[3] In *Central Bank*, the Supreme Court held that that there is no private right of action for aiding and abetting a violation of Section 10(b) of the Securities Exchange Act of 1934 (''Exchange Act''). That decision turned on the fact that the text of Section 10(b) does not provide for aiding-and-abetting liability.[4] The Board does not believe this decision affects the scope of the Board's explicit authority to set ethics standards under Section 103 of the Act.[5] Again, the Board notes that the profession's existing ethics code also reaches what can be characterized as ''secondary'' conduct contributing to a violation.[6]

The power to adopt Rule 3502 also is inherent in, and necessary to, the Board's authority to enforce PCAOB standards, rules, and related laws against both registered firms and their associated persons. Section 105 authorizes the Board to investigate and, when appropriate, discipline registered firms and their associated persons. Certain types of violations, by their nature, may give rise to direct liability only for a registered public accounting firm. Such firms, however, can only act through the natural persons that comprise them, many of whom are ''associated persons'' subject to the Board's ethics standards and disciplinary authority. When one or more of those associated persons has caused that firm to violate PCAOB standards, rules, or related laws with the requisite state of mind, it is appropriate, and consistent with the Board's duty to discipline registered

[2] *See AICPA Code of Professional Conduct*, ET section (''sec.'') 501, ''Acts Discreditable'' (''A member shall not commit an act discreditable to the profession.''). Interpretations of this part of the ethical code provide that an accountant member will be considered to have committed a discreditable act if, among other things, he or she: ''fails to comply with applicable federal, state or local [tax] laws or regulations,'' ET sec. 501.08, Interpretation 501–7; fails to follow applicable requirements of a governmental body, such as the SEC, in performing accounting services, ET sec. 501.06, Interpretation 501–5; or fails to follow government audit standards and rules in conducting a governmental audit, ET sec. 501.04, Interpretation 501–3.

[3] 511 U.S. 164 (1994).

[4] *See id.* at 190 (''Because the text of § 10(b) does not prohibit aiding and abetting, we hold that a private plaintiff may not maintain an aiding and abetting suit under § 10(b).'').

[5] Rule 3502, of course, differs from an aiding-and-abetting cause of action in important respects. Among other things, the rule does not apply whenever an associated person causes another to violate relevant laws, rules and standards. Rather, Rule 3502 applies only when an associated person causes a violation by the registered firm with which the person is associated.

[6] *See AICPA Code of Professional Conduct*, paragraph .02(2) of ET sec. 91, ''Applicability'' (''A member shall not knowingly permit a person, whom the member has the authority or capacity to control, to carry out on his or her behalf, either with or without compensation, acts which, if carried out by the member, would place the member in violation of the rules. Further, a member may be held responsible for the acts of all persons associated with him or her in the practice of public accounting whom the member has the authority or capacity to control.''); *see also* ET sec. 102.02, Interpretation 102–1(c) (violation of ethics rules not just to sign, but to ''permit[] or direct[] another to sign a document containing materially false and misleading information'') (adopted as a Board interim ethics rule in Rule 3500T).

firms and their associated persons under Section 101(c)(4) of the Act, that the Board be able to discipline the associated person for that misconduct.[7]

After carefully considering the comments received, the Board has determined, however, to modify the scope of Rule 3502 to apply only when an associated person causes the registered firm's violation due to an act or omission the person ''knew, or was reckless in not knowing, would directly and substantially contribute to such violation.'' This revised formulation reflects two changes to the rule as proposed.

First, the Board has determined to change the state-of-mind requirement in the rule. Specifically, Rule 3502, as adopted, will apply to ''an act or omission the [associated] person knew, or was reckless in not knowing,'' would cause the violation. While the Board believes it has the authority to adopt a negligence standard,[8] the Board believes the revised standard strikes the right balance in the context of this rule. The Board believes that the phrase ''knew, or was reckless in not knowing'' is a well-understood legal concept, and the Board intends for the phrase to be given its normal meaning.

Second, the Board has determined to modify the phrase used to describe the connection between the associated person's conduct and the violation. Specifically, Rule 3502, as adopted, provides that the associated person's act or omission must ''directly and substantially contribute to [the firm's] violation.'' In particular, ''substantially'' in this context means that the associated person's conduct (*i.e.*, an act or omission) contributed to the violation in a material or significant way. The term ''substantially'' also means, however, that the associated person's conduct does not need to have been the sole cause of the violation. ''Directly'' means that the associated person's conduct either essentially constitutes the violation—even though it is the firm and not the individual that actually commits the violation—or is a reasonably proximate facilitating event of, or a reasonably proximate stimulus for, the violation. ''Directly and substantially'' does not mean that the associated person's conduct must be the sole cause of the violation, nor that it must be the final step in a chain of actions leading to the violation. In addition, the term ''directly'' should not be misunderstood to excuse someone who knowingly or recklessly engages in conduct that substantially contributes to a violation, just because others also contributed to the violation, or because others could have stopped the violation and did not. At the same time, the term does not reach an associated person's conduct that, while contributing to the violation in some way, is remote from, or tangential to, the firm's violation.

A number of commenters expressed concern that adoption of a negligence standard would allow the Board, or the SEC, to proceed against associated persons who in good faith, albeit negligently, have caused a registered firm to violate applicable laws or standards. For example, commenters suggested that the proposed rule could be used against compliance personnel within a firm who inadvertently design a firm's compliance system in a flawed manner. Commenters also expressed concern that, because the SEC can enforce PCAOB rules under Section 3 of the Act, the Board's rule could have the practical effect of altering the state-of-mind requirement applicable in SEC enforcement proceedings against accountants.

It was not the Board's intention to establish a new standard for SEC enforcement of the securities laws and related applicable rules. The Board also recognizes that persons subject to its jurisdiction must comply with complex professional and regulatory requirements in performing their jobs. The Board does not seek to create through this rule a vehicle to pursue compliance personnel who act in an appropriate, reasonable manner that, in hindsight, turns out to have not been successful. Nor does the Board seek to reach those whose conduct, unbeknownst to them, remotely contributes to a firm's violation. At the same time, the Board continues to believe that it is necessary and appropriate for its ethics rules to apply when an associated person has engaged in an act or omission with knowledge that, or in reckless disregard of whether, it would directly and substantially contribute to a violation.[9]

The Board also believes that, because the rule is essential to the functioning of the Board's independence rules, this rulemaking provides the appropriate forum to adopt the rule. For example, Rule 3521 provides, in part, that a registered firm is not independent of its audit client if the firm provides that audit client with a service for a contingent fee. When an associated person causes, in a manner consistent with the discussion above, the registered firm to provide that service for a contingent fee, Rule 3502 would allow the Board to discipline the associated person for that conduct.[10]

Rule 3520—The Fundamental Independence Requirement

Rule 3520 sets forth the fundamental ethical obligation of independence: a registered public accounting firm and its associated persons must be independent of the firm's audit client throughout the audit and professional engagement period. This requirement encompasses the independence requirements set out in PCAOB Rule 3600T and goes further, as a matter of the auditor's ethical obligation, to encompass any other independence requirement applicable to the audit in the particular circumstances. Accordingly, in the case of an audit client subject to the financial reporting requirements of the securities laws and the SEC's rules, the ethical obligation under Rule 3520 requires the firm and its associated persons to maintain independence consistent with the SEC's requirements.[11]

By giving this scope to Rule 3520, the Board is not promulgating any new independence requirement. The Commission's independence requirements exist independently of Rule 3520 and are subject to change at the discretion of the Commission, without Rule 3520 purporting separately

[7] Some commenters suggested that the reference to ''any act, or practice * * * in violation of this Act'' in Section 105(c)(4)—the part of the Act authorizing the Board to impose certain sanctions—was inconsistent with the proposed rule. The Board notes, however, as it did in the proposing release, that Section 105(c)(5) expressly provides that the more severe of these sanctions may be imposed when intentional, knowing, or reckless conduct, or repeated instances of negligent conduct, ''results in'' violation of law, regulations, or professional standards.

[8] A number of commenters argued that Section 105(c) of the Act prevents the Board from imposing discipline based on a negligence standard. The Board's determination to change the rule's state-of-mind requirement to recklessness moots these comments. The Board notes, however, that Section 105(c)(5) identifies a range of sanctions that the Board may not impose in the absence of knowing conduct, reckless conduct, or repeated instances of negligent conduct. The Act does not similarly limit the Board's authority to impose certain other sanctions.

[9] While the Board's proposed rule tracked some of the language of Section 21C of the Securities Exchange Act of 1934 (''Exchange Act''), the rule, as adopted, differs significantly from, and should not be interpreted in pari material with, that statutory provision.

[10] Rule 3502, of course, is not the exclusive means for the Board to enforce applicable Board rules and standards against associated persons. Among other provisions, Rules 3100 and 3200T through 3600T directly require associated persons to comply with certain auditing and related professional practice standards. In addition, PCAOB standards generally contain directives to the ''auditor.'' The term ''auditor'' is defined in PCAOB Rule 1001(a)(xii) to include both registered firms and their associated persons. Accordingly, an associated person of a registered firm that does not comply with such a directive may be charged with violations of such other standards, independent of any charges under Rule 3502.

[11] 17 CFR 210.2–01.

to lock in place any aspect of those requirements. Instead, Rule 3520 is based on the simple premise that ethical standards for auditors can and should encompass a duty by the auditor to maintain independence necessary to ensure compliance with independence requirements in the circumstances of the particular engagement.

A note to the rule emphasizes the scope of the obligation in the rule by pointing out that, even in circumstances to which the Commission's Rule 2–01 applies, a registered public accounting firm and its associated persons still may need to comply with other independence requirements, including those requirements separately established by the Board. Using this foundation, the Board may adopt additional rules in the ''Independence'' subpart of the ethics rules that effectively set out additional requirements. As described below, with the new rules adopted today, the Board's independence rules include contingent fee arrangements and tax services.

After carefully considering the comments on proposed Rule 3520, the Board has determined to adopt the rule, with only one change. Most commenters supported the scope and content of the proposed rule. A few commenters, however, asked the Board to add text to the proposed rule to clarify or emphasize that the rule incorporates certain concepts in the existing independence requirements. While these comments are discussed in more detail below, the Board did not adopt these suggestions, as a general matter, because of the purpose of Rule 3520. Rule 3520 was simply intended to require, by Board rule, compliance with applicable independence requirements. The rule was not intended to, and does not, add to—or subtract from—these existing requirements. Nor is it intended to reflect the Board's conceptual approach to independence issues. Accordingly, while the Board does not necessarily disagree with the intent of the commenters who suggested adding text to the proposed rule, it does not believe it is necessary or appropriate to modify the rule to reflect their specific suggestions.

Three commenters suggested that Rule 3520 expressly require that auditors maintain independence from their audit client ''both in fact and appearance.'' As proposed, the rule already requires auditors to maintain independence both in fact and appearance, because the SEC's independence rules—which are incorporated in Rule 3520, as discussed above—are''designed to ensure that auditors are qualified and independent of their audit clients both in fact and in appearance.'' [12] In addition, Statement on Auditing Standard (''SAS'') No. 1, *Codification of Auditing Standards and Procedures*, adopted by the Board as an interim standard, requires that auditors ''not only be independent in fact; [but also] avoid situations that may lead outsiders to doubt their independence.'' [13] Therefore, the Board does not believe it is necessary to include this additional language in Rule 3520 to preserve these existing principles.

Some commenters also recommended that Rule 3520 expressly include the SEC's four overarching independence principles that it will look to in determining whether a particular service or client relationship impairs the auditor's independence.[14] Other commenters asked the Board to explicitly note in the rule that certain tax services are consistent with the SEC's four principles. For the reasons described above, the Board has decided not to change the rule in response to either of these suggestions. The Board notes, however, that the SEC's independence rules already refer to the four principles, and these rules must be complied with under Rule 3520.

Two commenters suggested that Rule 3520 include the text of the American Institute of Certified Public Accountants' (''AICPA'') Ethics Rule 102, which provides, in pertinent part, that members of the AICPA should avoid any subordination of their judgment.[15] Although the Board shares these commenters' view about the importance of this principle, the Board has already adopted Ethics Rule 102 as part of its interim ethics rule, Rule 3500T. Accordingly, this rule is already part of the Board's ethical standards and need not be separately repeated in Rule 3520 to be enforced by the Board.

Two firms suggested that Rule 3520, as proposed, might have the effect of precluding use of exceptions in the SEC's existing independence rules and asked the Board to avoid that result. Other than creating a requirement in a Board rule to comply with existing and applicable independence requirements, it does not add to, or detract from, the scope and substantive effect of these existing requirements in any respect.

The Board has, however, as suggested by a commenter, added ''associated persons'' to the rule. While the independence requirements added to the Board's rules through this rulemaking apply to the firm, other independence requirements covered by Rule 3520 are directed to individual accountants within auditing firms. Most notably, certain of the SEC's independence rules impose independence requirements directly on individual accountants.[16] Accordingly, the Board believes it is appropriate for the rule to apply to associated persons, as well as registered firms themselves. At the same time, the Board has added a new note to the rule to make clear that the rule applies only to those associated persons of a registered public accounting firm that are required to be independent of the firm's audit client by standards, rules, or regulations of the Commission or other applicable independence criteria.[17] Accordingly, the rule does not impose independence requirements on persons not already subject to them, and does not impose new independence requirements on any associated person. Rather, Rule 3520 only requires associated persons who are otherwise subject to independence requirements to comply, as an ethical obligation, with those requirements.

Rule 3521—Contingent Fees

The Board also has determined to adopt Rule 3521 as proposed. There was widespread support among commenters for the Board's view, expressed in the proposal, that certain fee arrangements used for the provision of tax services create per se conflicts of interest that impair auditors' independence from their audit clients. As discussed more fully in the proposing release, when an accounting firm provides a service to an audit client for a contingent fee, the firm's economic interests become

[12] 17 CFR 210.2–01, Preliminary Note 1; *accord United States* v. *Arthur Young & Co.*, 465 U.S. 805, 819 n.15 (1984).

[13] SAS No. 1, *Codification of Auditing Standards and Procedures*, paragraph .03 of AU sec. 220. The standard further states that ''[p]ublic confidence would be impaired by evidence that independence was actually lacking, and it might also be impaired by the existence of circumstances which reasonable people might believe likely to influence independence.'' *Id.*

[14] *See* 17 CFR 210.2–01, Preliminary Note 2. Specifically, under those principles, the SEC looks to whether a relationship or the provision of a service: (a) Creates a mutual or conflicting interest between the accountant and the audit client; (b) places the accountant in the position of auditing his or her own work; (c) results in the accountant acting as management or an employee of the audit client; or (d) places the accountant in a position of being an advocate for the audit client.

[15] *See AICPA Code of Professional Conduct*, ET sec. 102, ''Integrity and Objectivity''.

[16] *See*, *e.g.*, Rule 2–01(c)(1), 17 CFR 210.2–01(c)(1). *See also* PCAOB Rule 3600T.

[17] Other applicable independence criteria include any rules of the PCAOB, other than Rule 3520, that contain independence requirements directly applicable to associated persons of the firm, such as Rule 3600T.

aligned with the interests of its audit client in a manner that is inconsistent with the firm's role as independent auditor. The Board's rule was adapted from the SEC's rule prohibiting contingent fee arrangements [18] and thus treats registered firms as not independent if they enter into contingent fee arrangements with audit clients.

Specifically, Rule 3521 provides that a registered public accounting firm is not independent of its audit client [19] if the firm, or any affiliate of the firm,[20] during the audit and professional engagement period,[21] 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. The Board's definition of a contingent fee is ''any fee established for the sale of a product or the performance of any service pursuant to an arrangement in which no fee will be charged unless a specified finding or result is attained, or in which the amount of the fee is otherwise dependent upon the finding or result of such product or service.'' [22]

Fees fixed by courts or other public authorities and not dependent on a finding or result are excluded from this definition to permit contingencies that do not pose a risk of establishing a mutual interest between the auditor and the audit client. In the proposing release, the Board cited, as an example of such a permissible fee, fees approved by a bankruptcy court, as required under U.S. Federal bankruptcy law.[23] The Board also sought comment on whether there are courts or other public authorities that fix fees that are not dependent on a finding or result, other than bankruptcy courts, such that the term ''courts or other public authorities'' is necessary.

In response to this request, several commenters noted that they are not aware of any such authorities and encouraged the Board to eliminate the reference to ''other public authorities'' from the proposed rule. Other commenters suggested that the Board retain the phrase, even though they did not identify other contexts in which fees that are not contingent on a result of a ''product or service'' are nevertheless subject to approval by a court or other public authority.[24] After considering these comments, the Board has decided to retain the exception for fees that require approval of ''courts or other public authorities.'' The Board envisions that there may be fee approval schemes outside the U.S. that are analogous to U.S. bankruptcy law.

Although Rule 3521 and the related definition of ''contingent fee'' are modeled on the SEC's independence rules, as discussed in the Board's proposing release, they differ from those rules in that the Board's rules do not include the SEC's exception for fees ''in tax matters, if determined based on the results of judicial proceedings or the findings of governmental agencies.'' [25] As discussed in the Board's proposing release, this exception may have been misinterpreted in the past and is largely redundant of the exception for fees fixed by courts or other public authorities.[26] For these reasons, proposed Rule 3521 would eliminate this exception. The few commenters who addressed this issue agreed with the Board's reasoning and the elimination of this exception. Therefore, the Board's final rule does not include an exception for tax matters in which an auditor's fee agreement is based on the results of judicial proceedings or the findings of governmental agencies.

In addition, Rule 3521 treats a firm as not independent of an audit client if it receives a contingent fee or commission from that client ''directly or indirectly.'' The rule's use of the term ''indirectly'' is meant to prevent arrangements for a fee from any person that is contingent on a finding or result attained by the audit client. The Board's determination to include such fees within the prohibition is based on the principle that, regardless of who pays the contingent fee, such a contingency gives an auditor a stake in the audit client attaining the finding or result. Accordingly, under Rule 3521, it does not matter who pays the contingent fee, if it is contingent on a finding or result attained by the audit client or otherwise related to the firm's services for the audit client. That is, while use of an intermediary to disguise an audit client's agreement to a contingent fee is certainly prohibited, the rule is not limited to circumstances in which a contingent fee may be traced (*e.g.*, through an intermediary) to an agreement or payment by an audit client.

Comparable to the SEC's independence rules, proposed Rule 3521 treats contingent fee arrangements between a registered firm's affiliates and the registered firm's audit clients as relevant to the firm's independence.[27]

[18] *See* 17 CFR 210.2–01(c)(5).

[19] Rule 3501(a)(iv) defines ''audit client'' as ''the entity whose financial statements or other information is being audited, reviewed, or attested and any affiliates of the audit client.''

[20] Rule 3501(a)(ii) defines ''affiliate of the accounting firm'' as ''the accounting firm's parents; subsidiaries; pension, retirement, investment or similar plans; and any associated entities of the firm, as that term is used in Rule 2–01 of the Commission's Regulation S–X, 17 CFR 210.2–01(f)(2).''

[21] Rule 3501(a)(iii) adapts the definition of ''audit and professional engagement period'' from the definition of that term in the Rule 2–01 of the SEC's Regulation S–X, which includes both the period covered by the financial statements under audit or review and the period beginning when a registered public accounting firm signs an initial engagement letter (or when such a firm begins audit, review or attest procedures, whichever is earlier) and ends when the audit client notifies the SEC that the engagement has ceased. *See* 17 CFR 210.2–01(f)(5).

[22] Rule 3501(c)(ii). As discussed in the Board's proposing release, the term ''contingent fee'' includes the aggregate amount of compensation for a service, including any payment, service, or promise of other value, taking into account any rights to reimbursements, refunds, or other repayments that could modify the amount received in a manner that makes it contingent on a finding or result.

[23] 11 U.S.C. 328(a) (providing that, with a court's approval, a bankruptcy trustee may employ a professional person ''on any reasonable terms and conditions of employment, including on a retainer, on a fixed or percentage fee basis, or on a contingent fee basis'').

[24] One commenter suggested that arbitration panels should be captured in the final rule as an example of ''courts or other public authorities'' that may approve auditor fees. The Board is not aware, and the commenter did not appear to suggest, that any arbitration panels currently have authority, by contract or law, to approve the payment of fees to accountants. Therefore, the Board has not expanded the exception to include fees fixed by arbitration panels. Nevertheless, if an arbitration panel were by contract given the authority to approve accountants' fees, such fees would be permissible under the Board's rule so long as the determination of the fee was not contingent on the result of a product or service.

[25] 17 CFR 210.2–01(f)(10). By eliminating this exception from its rule, the Board expresses no view on any firm's compliance with Rule 2–01 of the Commission's Regulation S–X. *See* 17 CFR 210.2–01(c)(5).

[26] As the SEC Chief Accountant has stated, the SEC's ''tax matters'' exception only permits fee arrangements where the determination of the fee is ''taken out of the hands of the accounting firm and its audit client * * *., with the result that the accounting firm and client are less likely to share a mutual financial interest in the outcome of the firm's advice or service.'' Letter from Donald T. Nicolaisen, Chief Accountant, U.S. Securities and Exchange Commission, to Bruce P. Webb, Professional Ethics Executive Committee Chair, American Institute of Certified Public Accountants (May 21, 2004), *available at http://www.sec.gov/info/accountants/staffletters/webb052104.htm* (hereinafter ''Nicolaisen Letter'').

[27] The rule does so by providing that the firm is not independent if it ''or any affiliate of the firm * * * 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.'' The scope of the rule is intended to be the same as the scope of the Commission's rule, which defines the terms ''accountant'' and ''accounting firm'' to include such affiliates. Because registration with the Board is the basis for the Board's authority over an accountant, the rules would treat those persons that are related to a registered public accounting firm and satisfy the Commission's definition of ''accounting firm,'' but are not registered firms themselves, as ''affiliates of the accounting firm.''

The inclusion of such affiliates within the scope of those persons whose activities may impair the independence of a firm from an audit client is intended to prevent frustration of the rule's purpose through the use of firm subsidiaries and other affiliates.[28] The rule is not intended to, and does not, impose any requirements on affiliates of firms *per se*. Nonetheless, the conduct of an affiliate of the firm can cause the registered firm not to be independent in the situations specified in the rules.

Finally, one accounting firm commented that Rule 3521 should prohibit value-added fees because such fees could be used in lieu of contingent fees to achieve a similar effect as contingent fees. Fees that function as contingent fee arrangements are already prohibited under the SEC's rule against contingent fees,[29] and thus under the Board's final rule as well, whether such fees are labeled contingent fees, value-added fees, or otherwise. The SEC has indicated that it will closely monitor the use of value-added fees ''to determine whether a fee labeled a ''value added'' fee is in fact a contingent fee, such as where there are side letters or other evidence that ties the fee to the success of the services rendered,'' [30] and the Board intends to do so as well before, if necessary, considering additional rulemaking.

Rule 3522—Aggressive Tax Positions

Rule 3522 is intended to describe a class of tax-motivated transactions that present an unacceptable risk of impairing an auditor's independence if the auditor markets, plans, or opines in favor of, such a transaction. As discussed in the Board's proposing release, such conduct has seriously damaged investors' confidence in the judgment, objectivity, and ethics of firms that engage in such transactions. Further, aggressive tax positions carry a high risk that taxing authorities will not allow the position taken by the auditor and the audit client. As the SEC Chief Accountant noted in the context of contingent fees, ''the fact that a government agency might challenge the amount of the client's tax savings * * * heightens * * * the mutuality of interest between the firm and client.'' [31]

As proposed, Rule 3522 treated a firm as not independent of its audit client if the firm, or an affiliate of the firm, provided services related to planning, or opining on the tax consequences of a transaction that is a listed or confidential transaction under U.S. Department of Treasury (''Treasury'') regulations or that promoted an interpretation of applicable tax laws for which there is inadequate support. In order to describe such transactions in a manner that is clear and consistent with existing constructs for analyzing tax-oriented transactions, the rule is adapted from certain Treasury regulations and from the SEC's release accompanying its 2003 independence rules.

Commenters generally supported the notion that auditors should not provide tax services involving aggressive tax positions to their audit clients. They also supported the scope of Rule 3522, which as proposed covered listed transactions, confidential transactions, and other aggressive transactions. A number of commenters made suggestions to make the rule text clearer, however, and after considering such comments the Board has modified the rule in several respects.

First, several commenters suggested that the rule should make clear that it does not prohibit auditors from advising audit clients *not* to engage in an aggressive transaction. Rule 3522 was not intended to prevent such advice, so in response to these comments the Board has modified the rule to make clear the prohibition on opining on aggressive transactions is limited to ''opining *in favor of* the tax treatment of'' such transactions (emphasis added). Thus, auditors are permitted to advise *against* an audit client's execution of an aggressive tax transaction.[32] However, Rule 3522 prohibits an opinion that a transaction does not satisfy the more-likely-than-not standard but does satisfy a lower standard of confidence. Similarly, the rule prohibits advice that an audit client will ''probably'' lose an argument in favor of a tax treatment, because such advice can imply up to a 49-percent chance of success.

In addition, as recommended by one commenter, given recent concerns about accounting firms establishing marketing centers to sell tax shelter products, the Board has added the term ''marketing'' to the list of activities that compromise an auditor's independence. That is, under Rule 3522, as adopted, an auditor may not market an aggressive tax transaction to an audit client, in addition to being prohibited from ''planning, or opining in favor of the tax treatment of,'' such a transaction.

Finally, proposed Rule 3522(a)'s prohibition on auditors' involvement in listed transactions has been moved to become a part of the prohibition on involvement in aggressive tax position transactions, in light of the overlap of the two provisions and also in light of questions regarding whether the prohibition on listed transactions could apply in the context of a non-U.S. tax regime. Accordingly, Rule 3522 now provides for two categories of prohibitions related to aggressive tax transactions, whereas, as proposed, it had provided for three such categories. These two categories, as well as modifications of their proposed versions, are discussed below.

Rule 3522(b)—Aggressive Tax Position Transactions [33]

Rule 3522(b) would treat a registered firm as not independent if the firm, or

Thus, Rule 3501(a)(i) would adapt the Commission's definition of the term ''accounting firm'' to define the term ''affiliate of the accounting firm'' as ''the accounting firm's parents, subsidiaries, pension, retirement, investment or similar plans, and any associated entities of the firm, as that term is used in Rule 2–01 of the Commission's Regulation S–X, 17 CFR 210.2–01(f)(2).''

[28] *See, e.g., In re PricewaterhouseCoopers LLP, & PricewaterhouseCoopers Securities LLC,* Exchange Act Release No. 46216 (July 17, 2002), *available at http://www.sec.gov/litigation/admin/34–46216.htm* (finding an auditing firm and an affiliate under the control of the firm in violation of Commission requirements because the affiliate performed investment banking services for the firm's audit clients for contingent fees); In *KPMG, LLP* v. *Securities & Exch. Comm'n,* 289 F.3d 109 (D.C. Cir. 2002), the D.C. Circuit Court declined to find KPMG in violation of the AICPA's rule against contingent fees, where KPMG only indirectly received a contingent royalty from an audit client, through an associated entity of the firm. The Board's rules should be understood, however, to treat such an arrangement as an impairment of a registered firm's independence.

[29] *See* Revision of the Commission's Auditor Independence Requirements, SEC Release No. 33–7919, § IV.D.5 (Nov. 21, 2000), 17 CFR parts 210 and 240. Indeed, the SEC staff has cautioned audit committees against approving— any agreement '' from a direct contract provision to ''a wink and a nod''—that provides for the possible additional payment of a 'value added' fee based on the results of an accounting firm's performance of a tax or other service [that] would be viewed as impairing the firm's independence. In addition, an audit committee should consider carefully the impact on an accounting firm's independence of the possibility of even a completely voluntary payment of a ''value added'' fee by an audit client to the firm. Nicolaisen Letter, *supra* note 25.

[30] *See* Revision of the Commission's Auditor Independence Requirements, SEC Release No. 33–7919, § IV.D.5 (Nov. 21, 2000), 17 CFR parts 210 and 240.

[31] Nicolaisen Letter, *supra* 25.

[32] In addition, a number of commenters asked for clarification of the scope of Rule 3522's prohibition against ''opining'' on an aggressive transaction. The Board does not intend the rule to encompass the auditor's opinion on the fairness of financial statements that reflect the accounting for a transaction that an audit client has executed. Rather, Rule 3522 is intended to prevent auditors from facilitating clients' execution of aggressive transactions by, among other things, providing auditors' written tax opinions that protect the audit client from the assertion of penalties by tax authorities or courts.

[33] As proposed, this provision was entitled ''aggressive tax positions.'' One commenter questioned whether this title was intended to expand the scope of this provision beyond

Continued

an affiliate of the firm, provided an audit client any service related to marketing, planning, or opining in favor of the tax treatment of, a transaction that satisfies three criteria—

- The transaction was initially recommended, directly or indirectly, by the firm;
- A significant purpose of the transaction is tax avoidance; and
- The proposed tax treatment of the transaction is not at least more likely than not to be allowed under applicable tax laws.

Rule 3522(b) is adapted from the SEC's guidance to audit committees in its release accompanying its 2003 independence rules, which cautioned that audit committees should ''scrutinize carefully'' the retention of the auditor ''in a transaction initially recommended by the accountant, the sole business purpose of which may be tax avoidance and the tax treatment of which may be not supported in the Internal Revenue Code and related regulations.'' [34] The rule builds on this guidance from the perspective of the auditor, by providing that a registered firm is not independent of its audit client if the firm, or an affiliate of the firm, participates in such a transaction.

The first prong of the rule's test looks for transactions that the auditing firm—directly or indirectly, *e.g.*, through an affiliate, through or with another tax advisor with which the firm has an arrangement, or otherwise—initially recommended to the audit client. In this manner, the rule excludes from its scope those transactions that the audit client itself, or a party other than a tax advisor with which the firm has an arrangement [35] (*e.g.*, an acquiring corporation), initiated. The term ''initially recommended'' is intended to be a test based on fact. Thus, the prong would be satisfied, notwithstanding a representation from the audit client that the audit client initiated the development of the transaction,[36] if the auditor had knowledge that the auditor, its affiliate, or another tax advisor with which the firm has an arrangement, initially recommended it. As proposed, the rule would have looked for transactions that were ''initially recommended by the registered public accounting firm or another tax advisor.'' Some commenters expressed concern that an auditor might not be in a position to know whether another tax advisor with no relationship to the auditor had recommended a transaction. In response to these comments, the Board has modified the first prong of Rule 3522(b) to make clear that auditors are only responsible for ascertaining whether the firm, one of its affiliates, or another tax advisor with which the firm has a formal agreement or other arrangement related to the promotion of such a transaction, initially recommended the transaction.[37]

The second and third prongs of Rule 3522(b) incorporate concepts that have existing meaning and relevance to tax advisors. The second prong of the test set forth in Rule 3522(b) uses the phrase ''significant purpose of which is tax avoidance,'' adapted from the Internal Revenue Code.[38] The term ''tax avoidance'' should be understood to include acceleration of deductions into earlier taxable years and deferral of income to later taxable years. A few commenters noted that the test whether a significant purpose of a transaction is tax avoidance appears to be a low threshold that could encompass any plan to reduce taxes, and some of those commenters suggested that the Board raise that threshold. The Board intends for the threshold to be low, however, and therefore has not used terms that might seem to establish a higher threshold, such as requiring an evaluation of whether the ''sole purpose'' of a transaction is tax avoidance.

In addition, the rule uses the term ''more likely than not to be allowable under applicable tax laws,'' which is the standard certain taxpayers must meet, under Treasury regulations, to avoid penalties for substantial understatement of income tax in connection with a tax shelter.[39] This test is based, in part, on the Board's observation of some firms' policies that rely on the ''more likely than not'' standard to approve the firm's involvement in providing tax services relating to a transaction initiated by the firm. The rule also uses this standard because a tax treatment that is not ''more likely than not'' to be allowed poses a significantly higher risk of being challenged by taxing authorities, such that a mutuality of interest between the auditor and the audit client could arise.[40] Moreover, the rule uses this standard, as opposed to a higher standard, in recognition of the fact that tax laws may often be complex and subject to differing good faith interpretations.[41]

In order to satisfy Rule 3522(b)'s ''more likely than not'' standard, a registered public accounting firm must establish, based on an analysis of the pertinent facts and authorities, that there is a greater than 50-percent likelihood that the tax treatment of the transaction would, if challenged, be upheld.[42] To satisfy this test, an auditor's analysis must be objectively reasonable and well-founded at the time the analysis is conducted. The Board would not, however, treat an auditor as

transactions. In addition, the commenter noted that the term ''transaction'' was consistent with Treasury regulations. In response to this comment, the Board has re-titled this provision to be ''aggressive tax position transactions.''

[34] Strengthening the Commission's Requirements Regarding Auditor Independence, at § II.B.11 (Jan. 28, 2003).

[35] The term ''tax advisor'' is not intended to denote a group with a certain license or professional status, but rather to cover any person, other than the client, that recommends a tax transaction to the client.

[36] Two commenters indicated that, as they interpreted the term ''transaction,'' an auditor's tax services in connection with, for example, a merger transaction that was initiated by the client or another company, would not come within the ambit of Rule 3522(b), because the auditor would not have recommended the merger transaction itself. This is not a fair interpretation of the rule and indeed would thwart its purpose.

[37] *See* Rule 3522(b), Note 2. The term ''formal agreement or other arrangement'' in Note 2 relates only to relationships a registered firm may have with a tax advisor that is not already an affiliate of the firm.

[38] The Internal Revenue Code treats transactions with respect to which a ''significant purpose * * * is the avoidance or evasion of Federal income tax'' as tax shelters, for purposes of determining whether an adequate disclosure defense is available for the substantial understatement penalty. *See* 26 U.S.C. 6662(d)(2)(C) (amended by the Jobs Act; *see also* 26 U.S.C. 6662A(b)(2)(B) (imposing 20-percent penalty on understatements of tax in connection with ''any reportable transaction (other than a listed transaction) if a significant purpose of such transaction is the avoidance or evasion of Federal income tax'').

[39] *See* 26 CFR 1.6664–4(f).

[40] Some commenters noted that, while the term ''more likely than not'' is well-understood in the context of evaluating U.S. tax advice, it has not been used in non-U.S. contexts. One of these commenters also noted that this standard may be hard to judge in jurisdictions in which the rule of law does not always prevail. After considering these comments, the Board has determined to maintain the ''more likely than not standard,'' because it is an objective standard that may be applied in contexts outside the U.S. even where it has not applied to-date. Further, the Board notes that foreign private issuers ordinarily file U.S. tax returns and therefore are already expected to comply—and be familiar with—U.S. tax laws and regulations.

[41] A few commenters recommended that the Board use a standard higher than ''more likely than not,'' on the ground that there is some evidence that some accounting firms that used the ''more likely than not'' standard in the past have not adhered to it. While the Board is concerned about the record on this issue, the Board has determined not to use a higher standard at this time. The Board intends to monitor compliance with the rule through its inspections of registered public accounting firms and will consider revising the rule in the future, if that monitoring or other evidence reveals that the rule is not achieving its intended purpose.

[42] *Cf.* 26 CFR 1.6664–4(f)(2)(i)(B)(*1*) (incorporating by reference methodology set forth in 26 CFR 1.6662–4(d)(3)(ii) for analysis of whether a tax treatment has ''substantial authority'' or, in the case of tax shelters, is ''more likely than not'' the proper treatment, for purposes of determining whether a penalty may be due on a substantial understatement of income tax).

not independent if the law changed after the service was provided or if the tax treatment simply turned out to be not allowed, despite the auditor's reasonable judgment before the ultimate resolution of a tax claim or other dispute.

Rule 3522(b) does not require a registered public accounting firm to obtain a third-party opinion that a tax treatment is ''more likely than not'' to be allowed under applicable tax laws. On the contrary, while a firm may decide for its own reasons to obtain a third-party opinion, such an opinion would not relieve the firm of its obligation to form its own judgment on the likelihood of a proposed tax treatment to be allowed.[43]

Finally, although the SEC's release accompanying its 2003 independence rules cautioned audit committees to scrutinize situations in which a proposed tax treatment might not be supported ''in the Internal Revenue Code and related regulations,'' the proposed rule would use the term ''applicable tax laws'' in recognition of the variety of tax laws and regulations, including Federal, state, local, foreign, and other tax laws, that may be the subject of tax services. For this reason, and in response to questions from several commenters, the Board also incorporated its proposed prohibition on auditors providing tax services in connection with transactions that are listed by the IRS into Rule 3522(b). That is, IRS listing is one example of aggressive tax transactions covered by the rule.

Accordingly, the prohibition on advising in favor of listed transactions, which was proposed as Rule 3522(a), has been moved to a note to what is now Rule 3522(b). Specifically, Note 1 to Rule 3522(b) treats a registered public accounting firm as not independent of its audit client if the firm, or any affiliate of the firm, provided services related to marketing, planning, or opining in favor of the tax treatment of, a listed transaction. Under Treasury regulations, a listed transaction is ''a transaction that is the same as or substantially similar to one of the types of transactions that the IRS has determined to be a tax avoidance transaction and identified by notice, regulation, or other form of published guidance as a listed transaction.'' [44] The IRS uses its listing process to identify and publish a list of transactions that tax promoters and advisors have developed and sold to clients but that, in the IRS's view, do not comply with applicable laws. Thus, the Treasury's regulation on ''listed transactions'' identifies a class of transactions that, in the Board's view, carries an unacceptable risk of disallowance, which in turn create an unacceptable risk of establishing a mutuality of interest between the auditor and the audit client if the auditor participated in marketing, planning, or opining in favor of the tax treatment of a transaction that impairs independence. By referring to this class of transactions, Note 1 to Rule 3522(b) incorporates an existing framework that auditors who serve as tax advisors already follow in their tax practices and that is highly likely to remain current since the Treasury and the IRS regularly update guidance related to listed transactions.[45]

As discussed above, the Board's proposed prohibition on auditor involvement in transactions that are ''listed'' by the IRS has been moved to a note to Rule 3522(b). By definition, a listed transaction is not ''more likely than not to be allowable under applicable tax laws'' at the time the auditor advises on it. Because the risk of IRS or other scrutiny of listed transactions, including transactions that are substantially similar to listed transactions,[46] is high, tax advisors and taxpayers tend not to enter into such transactions once they are listed. In light of this fact, when it proposed this rule, the Board sought comment on whether the rule should treat an auditor as not independent if a transaction planned or opined on by the auditor subsequently became listed. In general, commenters recommended against adopting a *per se* rule that subsequent listing of such a transaction impaired an auditor's independence with respect to either the period in which the transaction was executed or in subsequent periods. The Board agrees that such a *per se* rule would not be appropriate, but as discussed below, firms should nevertheless be cautious in participating in transactions that they believe could become listed.

Even if a firm were independent at the time a transaction was executed, because it reasonably and correctly concluded the transaction was not the same as, or substantially similar to, a listed transaction, once a transaction is actually listed (or a substantially similar transaction becomes listed), a firm that has participated in the transaction may find its independence impaired due to the mutuality of interest caused by the listing. That is, depending on the circumstances, a firm's independence may become impaired in some cases after a transaction planned or opined on by the firm becomes listed. In such cases, the auditor should carefully consider the potential impairment of its independence with the audit committee of its audit client.[47] For example, 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. In addition, the firm may face liability to the audit client related to the firm's tax advice. The 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.

Some auditors commented that they would prefer a bright-line rule providing that, so long as a transaction recommended by the firm was not listed at the time it was executed, subsequent listing cannot impair an auditor's independence later in time, when the auditor is called on to defend its earlier

[43] Treasury regulations permit corporations to avoid penalties for substantial understatement of income taxes in connection with tax shelters if they ''reasonably rel[y] in good faith on the opinion of a professional tax advisor, if the opinion is based on the tax advisor's analysis of the pertinent facts and authorities * * * and unambiguously states that the tax advisor concludes that there is a greater than 50-percent likelihood that the tax treatment of the item will be upheld if challenged by the Internal Revenue Service.'' 20 CFR 1.6664–4(f)(2)(i)(B)(*2*). Rule 3522(b) would not permit registered public accounting firms, who themselves serve as tax advisors, to rely on other tax advisors to satisfy the rule's standard because registered firms that provide tax services are themselves in a position to perform such an analysis.

[44] *See, e.g.*, 26 CFR 1.6011–4(b)(2).

[45] The IRS updates the list of listed transactions by issuing a listing notice, both adding to and removing transactions from the list of listed transactions. *See, e.g.*, IRS Notice No. 2004–67, 2004–41 I.R.B. 600. Some commenters questioned whether the Board should effectively incorporate the IRS's changes to its list into the Board's rule on aggressive transactions. This is, indeed, the Board's intention. To freeze the IRS's list as of the date of the Board's final rule, or to establish a system of reviewing the IRS's list as it is updated, might permit auditors to provide tax services in favor of listed transactions notwithstanding that the IRS had identified those transactions as potentially abusive. Such a system would thwart the underlying intent of the Board's rule.

[46] By its terms, the Treasury regulation requiring reporting of listed transactions makes clear that the definition of ''listed transaction'' includes transactions that have been listed by the IRS as well as transactions that are ''substantially similar'' to such transactions. By expressly referring to the Treasury's regulation on listed transactions, the Board intends Rule 3522(b) to encompass such substantially similar transactions that are included in the Treasury's regulation.

[47] According to ISB Standard No. 1, which is incorporated in the Board's Rule 3600T interim independence standards, at least annually, an auditor must ''disclose to the audit committee of the company (or the board of directors if there is no audit committee), in writing, all relationships between the auditor and its related entities and the company and its related entities that in the auditor's professional judgment may reasonably be thought to bear on independence.''

tax advice. Such a bright-line rule, however, would do little to address circumstances in which, because of IRS scrutiny after execution of the transaction, the auditor's interest in the client's successful defense of the transaction becomes heightened to the point where the auditor can no longer be impartial about the financial statement presentation of the transaction. That said, as some commenters noted, existing independence requirements address these kinds of circumstances, and thus the Board has determined not to expand Rule 3522(b) either to retroactively deem an auditor not independent upon subsequent listing of a transaction or to deem an auditor not independent *per se* in the period in which such a transaction becomes listed.

Rule 3522(a)—Confidential Transactions

The Treasury has identified transactions with tax-advisor imposed conditions of confidentiality as potentially abusive. By regulation, the Treasury requires taxpayers to disclose to the IRS transactions in which a tax advisor ''places a limitation on disclosure by the taxpayer of the tax treatment or tax structure of the transaction and the limitation on disclosure protects the confidentiality of that advisor's tax strategies.'' [48] Tax-advisor imposed confidentiality may also be indicative of a tax product that a tax advisor intends to market to multiple customers, thus necessitating commitments by customers to treat the tax treatment or structure of the advisor's product as confidential.

As discussed in the proposing release, the Board is concerned that marketing, planning, or opining in favor of tax products that require confidentiality in order that they may be offered to multiple clients contributes to the erosion of public confidence in the ethics and integrity of such firms. A reasonable investor easily could infer that the auditor has a vested interest in advocating to the IRS the tax treatment it promoted, or helped to promote, to multiple clients and perpetuating that treatment in the audit client's financial statements. Based on these concerns, Rule 3522(a) treats a registered public accounting firm as not independent of its audit client if the firm, or an affiliate of the firm, provided services related to marketing, planning, or opining in favor of the tax treatment of a transaction for an audit client under terms that satisfy the definition of ''confidential transaction,'' as defined by Rule 3501(c)(i), which is adapted from the Treasury's regulation requiring tax advisors to report confidential transactions.[49]

It should be noted that, Rule 3501(c)(i) defines confidential transactions in terms of confidentiality restrictions imposed by tax advisors generally, not specifically auditors. Therefore, whereas under Rule 3522(b) a transaction that is initially recommended by a tax advisor other than the auditor or an affiliate of the auditor unless the tax advisor has an arrangement with the auditor does not fall within the first prong of the rule, Rule 3522(a) prohibits an auditor from marketing, planning, or opining in favor of a confidential transaction whether the applicable terms of confidentiality are imposed by the auditor or by another tax advisor, acting independently of the auditor.

Commenters generally supported the Board's proposed prohibition on confidential transactions. Although some commenters expressed the view that tax advisors might impose conditions of confidentiality for reasons other than the ability to market the proposed transaction to multiple clients, other commenters agreed that auditors should not become involved in transactions subject to tax-advisor imposed confidentiality restrictions. One accounting firm commenter also noted that, even if a transaction were not potentially abusive, the fact that there is a disclosure limitation is likely to create a negative impression concerning the objectivity of the auditor.

In addition, a few commenters suggested that the rule be limited to circumstances in which terms of confidentiality are imposed with respect to the U.S. tax treatment of a transaction. After carefully considering these comments, the Board has determined not to modify the scope of the rule. Tax-advisor imposed conditions of confidentiality facilitate aggressive selling of novel tax ideas that pose too great a risk of impairing the objectivity of auditors who market, plan, or opine in favor of them. Further, the rule continues to permit audit clients themselves to impose conditions of confidentiality in connection with transactions on which auditors may provide tax advice, and this fact appears to adequately serve audit clients' needs to maintain appropriate confidentiality. Finally, there does not appear to be a reasoned basis to limit the prohibition on confidential transactions to proposed tax treatments under U.S. tax laws.

Rule 3523—Tax Services for Persons in Financial Reporting Oversight Roles

Rule 3523 provides that a registered public accounting firm is not independent of an audit client if the firm, or any affiliate of the firm, during the audit and professional engagement period, provides any tax service to a member of management in a financial reporting oversight role at the audit client.[50] As discussed in the Board's proposing release, this rule addresses concerns that performing tax services for certain individuals involved in the financial reporting processes of an audit client creates an appearance of a mutual

[48] 26 CFR 1.6011–4(b)(3)(ii).

[49] 26 CFR 1.6011–4(b)(3) (2005). The proposed version of this rule incorporated the Treasury's definition of the term ''confidential transaction'' by reference. A number of commenters noted generally that incorporation of this Treasury regulation by reference could lead to unintended changes to the Board's rules if the Treasury amends those regulations (or the IRS amends its list of listed transactions). As discussed above, the Board intends for its prohibition on auditors' involvement as tax advisors in audit clients' execution of listed transactions to be kept current by changes to the IRS's list. Upon further consideration, unlike the Board's prohibition on listed transactions, the Board has determined that it may not be appropriate for any changes the Treasury may make to its definition of ''confidential transaction'' to automatically be reflected in the Board's prohibition on auditors' involvement in such a transaction. The definition of ''confidential transaction'' in Rule 3501(c)(i) is intended to be the same as the current Treasury regulation, except for the minimum fee requirement.

The proposed version of the rule did not incorporate the Treasury's minimum fee exception to its regulation on confidential transactions. That is, Treasury Regulation 1.6011–4(b)(3)(i) provides that ''a confidential transaction is a transaction that is offered to a taxpayer under conditions of confidentiality and for which the taxpayer has paid an advisor a minimum fee.'' 26 CFR 1.6011–4(b)(3) (2005). Under the regulation, the ''minimum fee'' is $250,000 for corporate taxpayers (and partnerships and trusts in which all of the owners or beneficiaries are corporations) and $50,000 for all other transactions. *Id.* 26 CFR 1.6011–4(b)(3)(iii). Although some commenters suggested that the Board should adopt the minimum fee exception, the Board understands the IRS disclosure rules to serve a different purpose than Rule 3522(a). Accordingly, the Board has not adopted a minimum fee exception in its final rule either.

[50] The rule's use of the term ''financial reporting oversight role'' is based on the Commission's definition of ''financial reporting oversight role,'' which includes any person who has direct responsibility for oversight over those who prepare the issuer's financial statements and related information (for example, management's discussion and analysis) that are included in filings with the Commission. *See* Strengthening the Commission's Requirements Regarding Auditor Independence, at § II.A. The Commission uses the term ''financial reporting oversight role'' to describe those positions that are covered by the Act's ''cooling off'' period, during which a public company would not be independent from its audit firm if a member of the engagement team for the audit of that company assumed such a position. *See* Sarbanes-Oxley Act of 2002, § 206, 17 CFR 210.2–01(f)(3)(ii). The term ''financial reporting oversight role'' as defined in Rule 3501(f)(i) mirrors verbatim the SEC's definition of the same term in Rule 2–01 of Regulation S–X. 17 CFR 210.2–01(f)(3)(ii).

interest between the auditor and those individuals.

The Board received varied comments on Rule 3523. Some commenters, including groups representing investors and issuers, as well as several large accounting firms, supported the proposed rule on the ground that it is necessary to preserve the objectivity, and the appearance of objectivity, of auditors. Other commenters, however, including a number of smaller accounting firms, accounting associations, and a few issuers, claimed that the rule is not necessary, that these services have long been provided, and that auditors should be allowed to provide senior financial management of issuers with the same types of tax services the auditor may provide the issuer. After carefully considering these comments, the Board has determined to adopt the rule, with a few modifications. The Board continues to believe that the provision of tax services by the auditor to the senior management responsible for the audit client's financial reporting creates an unacceptable appearance of the auditor and such senior management having a mutual interest.

The Board also received a number of comments on specific aspects of the proposed rule. For example, some commenters expressed confusion as to whether Rule 3523 is intended to apply to directors, in part because the definition of ''financial reporting oversight role'' includes directors. In response to these comments, the Board has modified the rule to exclude directors more explicitly. Thus, the rule no longer uses the term ''officer''—which is how the proposed rule narrowed the scope to exclude directors—and instead includes an explicit exception for any person who serves in a financial reporting oversight role ''only because he or she serves as a member of the board of directors or similar management or governing body of the audit client.'' [51]

The Board also included a second exception in Rule 3523(b) in response to comments regarding whether the rule should apply to persons who serve in a financial reporting oversight role at an affiliate of an issuer. After considering these comments, the Board has determined not to restrict auditors' provision of tax services to employees in a financial reporting oversight role at an affiliate of an audit client, so long as the financial statements of the affiliate are not material to the financial statements of the audit client or are audited by an auditor other than the firm or an associated person of the firm. This exception is intended to exclude executives of affiliates that do not contribute to the consolidated financial statements of the audit client. The Board does not believe that auditors' relationships with executives of immaterial affiliates, or affiliates whose financial statements are audited by an auditor other than the firm or an associated person of the firm, pose as great a risk to auditors' impartiality regarding an audit clients' consolidated financial statements as do auditors' provision of tax services to executives involved in the consolidated financial reporting of the client.

The first part of this exception, Rule 3523(b)(i), excludes persons in a financial reporting oversight role at immaterial affiliates of the entity being audited. This exception would encompass, among others, executives of most affiliates within the same investment company complex as the audited entity and executives of up-stream affiliates of the audited entity. The second part of this exception, Rule 3523(b)(ii), excludes executives in financial reporting oversight roles of a subsidiary of an audit client that is not audited by the firm or any firm that is an associated person of the firm, as defined by PCAOB Rule 1001. On the other hand, executives in financial reporting oversight roles at a material subsidiary whose financial statements are audited by a firm that is an associated person of the registered firm would be subject to Rule 3523. For purposes of Rule 3523(b)(ii), the term ''audited'' should be understood to include audit procedures that contribute to the firm's preparation or issuance of an audit report on an audit client's consolidated financial statements, whether or not such procedures result in an audit opinion on the affiliate's financial statements.

Some commenters also expressed concern that the rule could impose an 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. To address that concern, the Board determined to create a time-limited exception to the rule to cover such situations. Specifically, the Board has determined to add a new exception to the rule that applies to a person who was not in a financial reporting oversight role at the audit client before a hiring, promotion, or other change in employment event, when the tax services are both: (1) Provided pursuant to an engagement that was 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.[52] The Board will treat engagements as ''in process'' if an engagement letter has been executed and substantive work on the engagement has commenced; the Board will not treat engagements as ''in process'' during negotiations on the scope and fee for a service.

Some commenters also suggested that, as proposed, Rule 3523 could invite persons subject to the rule to evade the rule by using the auditor's tax services through an immediate family member or through an entity controlled by the person. In response to this comment, the Board has added to the scope of the rule immediate family members of persons who are covered by the rule.[53]

In addition, some commenters suggested that the rule be expanded to cover all non-audit services, such as services involving investment, personal financial planning, and executive compensation, on the ground that any such services provided to those in a financial reporting oversight role create a perception of a mutuality of interest between auditors and those members of management who receive such services.[54] Other commenters suggested that the rule be expanded to include persons who do not play a financial reporting oversight role but nevertheless play a key role in operations, such as vice presidents of sales.[55] Other

[51] Rule 3523(a).

[52] Rule 3523(c).

[53] The Board also has added a definition of ''immediate family member,'' adapted from the SEC's definition in its independence rules. *Compare* Rule 3501(i)(i) *with* 17 CFR 210.2–01(f)(13). The Board has not included entities controlled by persons in financial reporting oversight roles, such as trusts and investment partnerships. The Board notes, however, that an auditor who provides services to an entity controlled by a person in a financial reporting oversight role of an audit client should consider whether, under ISB Standard No. 1, it is necessary to notify the client's audit committee of such services.

[54] Some commenters asked for clarification of whether persons in a financial reporting oversight role could seek the assistance of the registered public accounting firm that prepared the original tax return to assist them in responding to an IRS or other governmental agency examination regarding that specific tax return after Rule 3523 becomes effective. 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, Such assistance, of course, must be otherwise consistent with Board and SEC auditor independence rules, including the requirement the auditor not become an advocate for its audit client.

[55] A few commenters suggested that the Board use the list of officers in section 16 of the Exchange Act, rather than relying on the defined term ''financial reporting oversight role.'' The ''financial reporting oversight role'' term, however, includes those individuals at an audit client that, because of their

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commenters recommended the rule cover audit committee members. Still other commenters, however, disagreed with these commenters and noted that applying the rule to audit committee members might serve as a practical disincentive to audit committee service.

The Board has determined not to expand the final rule to include all non-audit services, directors or persons outside the definition of ''financial reporting oversight role.'' To date, the concerns that have arisen in this area have related to auditors' provision of tax services to executives of public companies. Accordingly, the Board believes it is appropriate, at this time, to limit the rule to address this problem. The Board intends to monitor implementation of the rule, however. In addition, to the extent that issuers pay for non-audit services provided to any individuals, audit committees can and should be scrutinizing the potential effects on the auditor's independence due to such services. Further, as discussed in the proposing release, although accounting firms are not now required to seek pre-approval for executive tax services paid directly by the employee, auditors should consider under Independence Standards Board (''ISB'') Standard No. 1 whether it is necessary to notify the audit committee of these services [56] or whether it is otherwise advisable to inform audit committees of such services.[57] In this regard, while the Board is reluctant to establish a *per se* prohibition on auditors' provision of tax services to directors of their audit clients, the Board notes that firms can—and some have—adopted procedures to notify the audit committee of such services so it may evaluate the potential effect of such services on the auditor's independence.[58]

Rule 3524—The Auditor's Responsibilities in Connection With Audit Committee Pre-approval of Tax Services

Under Section 10A(h) of the Exchange Act, as amended by Section 202 of the Sarbanes-Oxley Act, all non-audit services that the auditor proposes to perform for an issuer client ''shall be pre-approved by the audit committee of the issuer.'' The SEC's 2003 independence rules implemented the Act's pre-approval requirement by adopting a provision on audit committee administration of the engagement.[59] Rule 3524 implements the Act's pre-approval requirement further by strengthening the auditor's responsibilities in seeking audit committee pre-approval of tax services. Specifically, Rule 3524 requires a registered public accounting firm that seeks pre-approval of an issuer audit client's audit committee [60] to perform tax services that are not otherwise prohibited by the Act or the rules of the SEC or the Board to—

- Describe, in writing, to the audit committee the nature and scope of the proposed tax service;
- Discuss with the audit committee the potential effects on the firm's independence that could be caused by the firm's performance of the proposed tax service; and
- Document the firm's discussion with the audit committee.

These requirements are intended to buttress the pre-approval processes established by the Act and the Commission's rules. Whether an audit committee pre-approves a non-audit service on an *ad hoc* basis or on the basis of policies and procedures, the Commission staff has stated that ''detailed backup documentation that spells out the terms of each non-audit service to be provided by the auditor'' should be provided to the audit committee.[61] Indeed, the SEC staff has indicated ''[s]uch documentation should be so detailed that there should never be any doubt as to whether any particular service was brought to the audit committee's attention and was considered and pre-approved by that committee.'' [62]

Rule 3524 implements the Act's pre-approval requirement further by requiring that registered firms provide the audit committee of an issuer audit client a description of proposed tax services engagements that includes descriptions of the scope of any tax service under review and the fee structure for the engagement.[63] Some commenters suggested significant changes to the scope of the proposed rule. One group of commenters recommended that the rule be broadened to apply to all non-audit services, rather than only tax services. Other commenters expressed concern that the rule appeared to impose restrictions on audit committee pre-approval in excess of the SEC's requirements and, for that reason,

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oversight of the company's financial reporting process, raise special concerns when they have certain relationships with the auditor. For this reason, the Board continues to believe this is the appropriate group to include in this rule.

[56] *See* ISB Standard No. 1; *see* also Memorandum from Scott A. Taub, Deputy Chief Accountant, Office of the Chief Accountant, U.S. Securities and Exchange Commission to William H. Donaldson, Chairman, Securities and Exchange Commission at 5 (June 24, 2003) (attached to letter from Chairman William H. Donaldson, U.S. Securities and Exchange Commission, to Five Consumer Groups) (July 11, 2003), *available at http://www.sec.gov/info/accountants/staffletters/taub071103.pdf* (hereinafter ''Taub Memo'').

[57] For example, the SEC staff has recommended that audit committees scrutinize audit firms' provision of these services—The provision of tax services to the executives of an audit client is not expressly addressed in the Act or in the Commission's rules. Nonetheless, an audit committee should review the provision of those services to assure that reasonable investors would conclude that the auditor, when providing such services, is capable of exercising objective and impartial judgment on all issues within the audit engagement.

Taub Memo, *supra* note 55, at 5.

[58] *See*, *e.g.*, Remarks of Scott Bayless, Deloitte & Touche LLP, *Auditor Independence Roundtable on Tax Services* (July 14, 2004) at 152 (indicating that even when ''the company does not pay for those services * * * there is a notification procedure to ensure that the audit committee has the ability to take control of that relationship if they so desire'').

[59] *See* 17 CFR 210.2–01(c)(7).

[60] Proposed Rule 3524 used the term ''audit committee of the audit client,'' which some commenters interpreted to mean that the rule would require auditors to make the required communications in connection with proposed tax services for affiliates of an audit client that are not consolidated as subsidiaries with the audit client for financial statement purposes. One commenter noted that the Commission's Rule 2–01(c)(7) requires only that ''[b]efore the accountant is engaged by the issuer or its subsidiaries, or the registered investment company or its subsidiaries, to render audit or non-audit services, the engagement [be] approved by the issuer's or registered investment company's audit committee.'' By using the phrase ''in connection with seeking audit committee pre-approval,'' the Board intends Rule 3524 to apply only when the SEC's Rule 2–01(c)(7) requires such approval. Accordingly, the rule does not require registered firms to make the specified communications or to seek audit committee pre-approval in any situations in which audit committee pre-approval is not already required by the SEC's rules. Nor should the rule be understood to require pre-approval by any committee other than the committee required to provide pre-approval by the SEC's rules. To clarify this issue, the Board has also modified Rule 3524 to more clearly track the language of section 10A(h) of the Exchange Act and the SEC's Rule 2–01(c)(7).

[61] Taub Memo, *supra* note 55, at 3; *see also* SEC Office of the Chief Accountant: Application of Commission's Rules on Auditor Independence Frequently Asked Questions, Audit Committee Pre-approval, Question 5, (issued August 13, 2003), *available at http://www.sec.gov/info/accountants/ocafaqaudind121304.htm* (hereinafter ''FAQs'').

[62] Taub Memo, *supra* note 55, at 3; *see also* FAQs, *supra* note 60, Audit Committee Pre-approval, Question 5 (issued August 13, 2003). The SEC staff FAQ answer states that (''[p]re-approval policies must be designed to ensure that the audit committee knows precisely what services it is being asked to pre-approve so that it can make a well-reasoned assessment of the impact of the service on the auditor's independence. For example, if the audit committee is presented with a schedule or cover sheet describing services to be pre-approved, that schedule or cover sheet must be accompanied by detailed back-up documentation regarding the specific services to be provided'').

[63] *See* Rule 3524(a)(1). Audit committees may ask auditors for other materials not identified in the rule, to assist them in their determinations whether to pre-approve proposed tax services. Rule 3524 should not be understood to limit the information or materials that an audit committee may request, or that a registered firm may decide to provide, in connection with the pre-approval of tax services.

recommended that the Board narrow or eliminate the rule. The Board has determined not to change the scope of the rule in response to these comments. While auditors and audit committees may find the procedures in Rule 3524 to be useful for purposes of considering non-audit services generally, the Board adopts these rules only after having engaged in a substantial effort to obtain facts and views of interested persons on appropriate procedures for considering proposed tax services. Before considering broadening the rule, the Board would seek additional information, based, among other things, on experience with this rule, inspections of registered firms, and additional public input. On the other hand, notwithstanding the concerns of some commenters that Rule 3524 requires more than the parallel SEC rule, the Board has determined not to narrow or eliminate the rule. The Board continues to believe that the rule is an appropriate complement to the SEC's pre-approval rule. Rule 3524 supports the procedure under the SEC rule, by requiring the auditor—who is in the best position to describe a proposed engagement—to gather the information required to be presented to the audit committee by the SEC rule. Indeed, it is the SEC rule and staff interpretations of what information audit committees need that have informed the Board's development of the rule.

The Board has made certain modifications to the proposed rule, however. As proposed, the rule would have required auditors to provide audit committees copies of all engagement letters for proposed tax services. While some commenters supported this proposal as a way to ensure that audit committees received adequate information on which to base their judgments, other commenters expressed concern that the rule could result in audit committees being provided voluminous stacks of engagement letters—some in foreign languages—that would obscure rather than elucidate the nature of the tax services proposed. On the basis of this information, and because the underlying purpose of the proposed requirement was to establish a manageable collection of information on which audit committees could make their determinations to pre-approve tax services, the Board has determined to eliminate the proposed rule's requirement to supply the audit committee a copy of each tax service engagement letter. Instead, the rule requires auditors to describe for audit committees, in writing, the scope of the proposed service, the proposed fee structure for the service, and the potential effect of the service on the auditor's independence. The Board believes requiring such a description of a proposed service better meets the Board's goal to improve the quality of information auditors provide audit committees about proposed tax services.

The rule also requires the auditor to describe for the audit committee any amendment to the engagement letter or any other agreement relating to the service (whether oral, written, or otherwise) between the firm and the audit client.[64] While the Board does not expect or encourage auditors to enter into side agreements relating to tax services, the Board understands that, in the past, some accounting firms have entered into such agreements.[65] To the extent firms do so, they must disclose those agreements to the audit committee.

In addition, to the extent that a firm receives fees or other consideration from a third party in connection with promoting, marketing, or recommending a tax transaction, Rule 3524 requires the firm to disclose those fees or other consideration to the audit committee. Specifically, Rule 3524(a)(2) requires that the firm disclose to the audit committee ''any compensation arrangement or other agreement, such as a referral agreement, a referral fee or fee-sharing arrangement, between the registered public accounting firm (or an affiliate of the firm) and any person (other than the audit client) with respect to the promoting, marketing or recommending of a transaction covered by the service.'' This provision is adapted from the IRS's rules of practice, which require tax advisors to disclose such arrangements to taxpayer clients.[66]

Rule 3524(b) also requires registered public accounting firms to discuss with audit committees of their issuer audit clients the potential effects of any proposed tax services on the firm's independence. Even if a non-audit service does not *per se* impair an auditor's independence, the Commission's independence rules nevertheless deem an auditor not to be independent if—

> the accountant is not, or a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the accountant is not, capable of exercising objective and impartial judgment on all issues encompassed within the accountant's engagement.[67]

Rule 3524(b) is intended to provide audit committees a robust foundation of information upon which to determine whether to pre-approve proposed tax services. Some commenters have asked for guidance as to the scope of the discussions intended by the rule. The Board intends that the scope of such discussions remain flexible, to address the matters that are pertinent in the judgment of the audit committee, as informed by Commission requirements. While the Act's legislative history makes clear that the Act ''does not require the audit committee to make a particular finding in order to pre-approve an activity,'' [68] the Commission's staff expects a robust review of proposed non-audit services—

> The audit committee must take its role seriously and perform diligent analyses and reviews that allow the committee to conclude that reasonable investors would view the auditor as capable of exercising objective and impartial judgment on all matters brought to the auditor's attention.[69]

To be clear, the rule does not prescribe any test for audit committees or require audit committees to make legal assessments as to whether proposed services are prohibited or permissible. Nor is the rule intended to limit an audit committee's discretion to establish its own more stringent pre-approval procedures. Rather, the rule directs registered firms to present detailed information and analysis to audit committees for audit committees' consideration, in their own judgment, of

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[64] *Id.* One commenter expressed concern that Rule 3524(a)'s requirement to describe an ''other agreement'' could be understood to require the auditor to submit to the audit committee documentation concerning ''essentially every communication with the audit client.'' The Board believes this comment is misplaced. Rule 3524 does not require that the auditor describe all communications with the audit client, but rather all agreements with the audit client that relate to the proposed service.

[65] *See, e.g.*, *In re PricewaterhouseCoopers LLP, & PricewaterhouseCoopers Securities LLC*, *supra* note 27 (''through side letters or oral understandings, the parties created contingent fee arrangements''). In addition, some commenters have expressed concern that Rule 3524 requires disclosure to the audit committee of fee arrangements that are prohibited by Rule 3521 (or by professional association membership requirements, such as certain referral agreements and fees). Those commenters have asked the Board to clarify that Rule 3524 does not operate to permit such fee structures that are otherwise prohibited by the Board's rules or to endorse fee structures that are prohibited or discouraged by professional ethics rules. It is the case that Rule 3524 does not permit or otherwise endorse such fees.

[66] *See* 31 CFR 10.35(e)(1) (2005), *available at http://www.irs.gov/pub/irs-pdf/pcir230.pdf.*

[67] 17 CFR 210.2–01(b).

[68] S. Rep. No. 107–205, at 19 (2002).

[69] Taub Memo, *supra* note 55, at 7–8; *see also* FAQs, *supra* note 60, Audit Committee Pre-approval, Question 5 (issued August 13, 2003).

the best interests of the issuer and its shareholders.

In addition, through the discussion required by Rule 3524(b), the Board expects registered firms to convey to the audit committee information sufficient to distinguish between tax services that could have a detrimental effect on the firm's independence and those that would be unlikely to have a detrimental effect. Some commenters expressed concern that an example of such a distinction that the Board provided in the proposing release could be understood to suggest that audit committees should not permit an auditor to provide any tax services unless the company had an internal tax department and/or a tax director who could make sound management decision in the best interest of the company. The Board did not intend to suggest that particular functional departments or managers must exist at a company before its auditor may provide it tax services. Rather, the inquiry the auditor should engage in when proposing to provide tax services to an audit client is whether, in the particular case, the company has the capacity to make its own decisions regarding the proposed tax matter, such that the auditor would not be in the position of performing management functions or making management decisions for the company.[70] The resolution of this inquiry will vary depending on the nature of the tax matter at issue and the sophistication of the company, among other things.

Rule 3524, both as proposed and as adopted, is intentionally silent as to when a registered public accounting firm should provide the required information about a proposed tax service to an audit committee. This is because, under the SEC's 2003 independence rules, audit committees themselves may have policies that establish a procedure and schedule for audit committee review of non-audit services, including tax services.[71] Some commenters expressed concern that the rule might favor one approval method (*ad hoc*) over another (approval pursuant to policies and procedures). This is not the case. Similar to the SEC's 2003 independence rules, Rule 3524 does not dictate, or even express a preference as to, whether the documentation and discussions required under Rule 3524 should take place pursuant to an audit committee's policies and procedures on pre-approval or on an ad hoc basis. Many issuers have adopted policies that provide for pre-approval in annual audit committee meetings. The Board understands that such an annual planning process can include as robust a presentation to the audit committee as a case-by-case pre-approval process, and Rule 3524 is designed to be flexible enough to accommodate either system and to encourage auditors and audit committees to develop systems tailored to the needs and attributes of the issuer.

The timing and method by which auditors describe for, and discuss with, audit committees proposed tax services will necessarily vary depending on different audit committees procedures. For those audit committees that hold an annual meeting to consider proposed non-audit services for the upcoming year, often by reviewing a proposed annual budget for non-audit services, it would be appropriate for auditors to provide their disclosures pursuant to Rule 3524(a), and hold their discussions pursuant to Rule 3524(b), about proposed tax services that are known at the time of the meeting in connection with or at that meeting. In addition, some audit committees' policies delegate authority to pre-approve non-audit services to one committee member and require reporting of any services approved by delegated authority at the next scheduled audit committee meeting, on a quarterly basis, or otherwise, in order for the audit committee to review an updated forecast or other summary of non-audit services. In such cases, it would be appropriate for auditors to provide the member holding delegated authority to approve a tax service a description of the service that complies with Rule 3524(a). Also, although the auditor may discuss the service with the member holding delegated authority when the member is considering the service, in order to comply with Rule 3524(b), the auditor ought to discuss the service with the audit committee as a whole when the audit committee considers the updated forecast or other summary.

Finally, Rule 3524(c) requires a registered public accounting firm to document the substance of its discussion with the audit committee under subparagraph (b). The few commenters who addressed this provision supported it.[72]

Effective and Transition Dates

The Board intends that the rules become effective at varying times.

In light of pre-existing legal and regulatory requirements, Rules 3502 and 3520 do not, in any practical sense, create new criteria for appropriate conduct. Accordingly, no transition period is called for, and therefore the Board intends that Rules 3502 and 3520, as well as the definitions in Rule 3501, become effective 10 days after the date that the SEC approves the rules.

Rule 3521 is based on the SEC's existing contingent fee rule, although it differs from that rule in certain respects. Accordingly, the Board will not apply Rule 3521 to contingent fee arrangements that were paid in their entirety, converted to fixed fee arrangements, or otherwise unwound before the later of December 31, 2005, or 10 days after the date that the SEC approves the rules. Of course, as noted above, the Commission's Rule 2–01 on auditor independence treats an auditor as not independent if it enters into a contingent fee arrangement with an audit client today.[73]

Rules 3522, 3523, and 3524 establish new criteria for appropriate conduct by registered public accounting firms and their associated persons. The Board believes it is appropriate to allow a reasonable period of time for such firms to prepare internal policies and procedures, and train their employees to ensure compliance with these new requirements. In addition, the Board understands that engagements covered by these rules may be in progress and that firms will need to terminate or complete these engagements in a professional manner. Accordingly, the Board believes it is appropriate to allow transition periods for these rules.

The Board understands that Rule 3523 will, in practical effect, lead to some registered firms terminating recurring engagements to provide tax services and may require certain members of public companies' senior management to find other tax preparers. Accordingly, the Board has determined that it will not apply Rule 3523 to tax services being provided pursuant to an engagement in process at the time the SEC approves the rules, provided that such services are completed on or before the later of June 30, 2006 or 10 days after the date that the SEC approves the rules. As

[70] *See* PCAOB Rule 3600T (adopting *AICPA Code of Professional Conduct*, paragraph .05 of ET sec. 101, ''Independence'', Interpretation No. 101–3, ''Performance of Other Services,'' as of April 16, 2003) (''care should be taken not to perform management functions or make management decisions for attest clients the responsibility for which remains with the client's board of directors and management.'') (Interpretation No. 101–3 was later amended by the AICPA in December 2003).

[71] 17 CFR 210.2–01(c)(7)(i)(B).

[72] One commenting auditor suggested that the Board consider requiring specific forms or occasions for auditor documentation of audit committee discussion. After considering this suggestion, the Board has determined that such forms or required timing of discussions could unnecessarily limit the scope of the discussions that, in the judgment of the auditor and audit committee, are appropriate.

[73] 17 CFR 210.2–01(c)(5).

discussed above, the Board will treat engagements as ''in process'' if an engagement letter has been executed and work of substance has commenced; the Board will not treat engagements as ''in process'' during negotiations on the scope and fee for a service.

Although the Board does not expect them to require the same transition as Rule 3523, Rules 3522 and 3524 also impose new legal requirements. Accordingly, the Board has determined that it will not apply Rule 3522 to tax services that were completed by a registered public accounting firm no later than the later of December 31, 2005, or 10 days after the date that the SEC approves the rules. Rule 3524 will not apply to any tax service pre-approved before the later of December 31, 2005, or 10 days after the date that the SEC approves the rules, or, in the case of an issuer that pre-approves non-audit services by policies and procedures, the rule will not apply to any tax service provided by March 31, 2006.

The Technical Amendments

On November 22, 2005, the Board adopted technical amendments to Rules 3502 and 3522 and revised the effective dates for certain of the rules. The Board described these amendments as follows:

After discussions with the SEC staff, the Board has decided to remove the word ''cause'' from the title and text of Rule 3502. This amendment is intended to avoid any misperception that the rule affects the interpretation of any provision of the federal securities laws. The rule, as amended, should be interpreted and understood to be the same as the rule adopted by the Board in July, however.[74] In particular, under the amended rule, the person's conduct must have the same relation to the violation and the person must act with the same mental state as under the rule the Board adopted in July.

The Board is also amending Note 1 to Rule 3522(b) to correct a typographical error in the citation of the provision of the Internal Revenue Code cited in that note.

In light of the time that has elapsed since their adoption, the Board has also decided to revise the effective dates for certain of the rules. Three of those rules '' Rules 3521, 3522 and 3524 '' had effective dates of the later of December 31, 2005 or 10 days after the date the SEC approves the rules.[75] The Board has decided to revise the effective dates of those three rules to 60 days after the date the SEC approves the rules.[76]

Specifically, the Board will not apply Rule 3521 to contingent fee arrangements that were paid in their entirety, converted to fixed fee arrangements, or otherwise unwound before 60 days after the date that the SEC approves the rules.[77] The Board will not apply Rule 3522 to tax services that were completed by a registered public accounting firm no later than 60 days after the date that the SEC approves the rules. Rule 3524 will not apply to any tax service pre-approved before 60 days after the date that the SEC approves the rules, or, in the case of an issuer that pre-approves non-audit services by policies and procedures, the rule will not apply to any tax service provided by March 31, 2006. Combined with the time period since the rules' adoption, the extension of the effective dates for these rules should allow reasonable time for affected firms to prepare internal policies and procedures, train their employees to ensure compliance with the new requirements, and, if necessary, terminate or complete any ongoing engagements covered by the rules in a professional manner.

III. Date of Effectiveness of the Proposed Rule and Timing for Commission Action

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Board consents, the Commission will:

(a) By order approve such proposed rule; or

(b) Institute proceedings to determine whether the proposed rule should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rules are consistent with the requirements of Title I of the Act. The Commission also requests specific comment on the following:

Regarding proposed Rule 3522, the Board indicates that while an auditor's independence is not impaired *per se* upon a subsequent listing of a transaction under the regulations of the Department of Treasury or the Internal Revenue Service, ''firms should nevertheless be cautious in participating in transactions that they believe could become listed.'' The Board further states that, if a transaction later becomes listed, the auditor ''should carefully consider the potential impairment of its independence with the audit committee of its client.'' For example, the Board states that the ''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.'' The Board also declined to adopt a bright-line rule providing that, so long as a transaction recommended by the firm was not listed at the time it was executed, subsequent listing could not impair an auditor's independence at the later date. Instead, the Board notes that the requirement for the auditor to consider, on a forward-looking basis, whether such a situation may reasonably be thought to bear on its independence is addressed in existing independence requirements. As such, the Board determined not to expand proposed Rule 3522(b) to specifically address this issue. We request comment on this discussion. 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 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?

Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (*http://www.sec.gov/rules/pcaob.shtml*); or
- Send an e-mail to *rule-comments@sec.gov*. Please include File Number PCAOB–2006–01 on the subject line.

Paper Comments

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–1090.

All submissions should refer to File No. PCAOB–2006–01. This file number

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[74] *See* PCAOB Release No. 2005–014 (July 26, 2005), at 9–14 (discussing Rule 3502).

[75] *See id.*, at 47–48.

[76] The effective dates of Rules 3501, 3502, 3520 and 3523 are not changed by this release and remain as set forth in the Board's adopting release. *Id.*

[77] Of course, the Commission's Rule 2–01 on auditor independence treats an auditor as not independent if it enters into a contingent fee arrangement with an audit client today. 17 CFR 210.2–01(c)(5).

should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (*http://www.sec.gov*). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Section, 100 F Street, NE., Washington, DC 20549–1090. Copies of such filing also will be available for inspection and copying at the principal office of PCAOB. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should be submitted on or before April 3, 2006.

By the Commission.

Nancy M. Morris,

Secretary.

[FR Doc. 06–2365 Filed 3–10–06; 8:45 am]

BILLING CODE 8010–01–P

SECURITIES AND EXCHANGE COMMISSION

[File No. 500–1]

In the Matter of Gary Player Direct, Inc., First Chesapeake Financial Corp., and North Lily Mining Co.; Order of Suspension of Trading

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Gary Player Direct, Inc. because it has not filed a periodic report since the period ending December 31, 1999.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of First Chesapeake Financial Corp. because it has not filed a periodic report since the period ending September 30, 2003.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of North Lily Mining Co. because it has not filed a periodic report since the period ending September 30, 2000.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed companies.

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the above-listed companies is suspended for the period from 9:30 a.m. EST on March 9, 2006, through 11:59 p.m. EST on March 22, 2006.

By the Commission.

Nancy M. Morris,

Secretary.

[FR Doc. 06–2412 Filed 3–9–06; 11:40 am]

BILLING CODE 8010–01–P

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–53403; File No. SR–Amex–2006–04]

Self-Regulatory Organizations; American Stock Exchange LLC; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto Relating to Procedures for Denying Initial and Continued Listing

March 2, 2006.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the ''Act''),[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on January 23, 2006, the American Stock Exchange LLC (''Amex'' or ''Exchange'') filed with the Securities and Exchange Commission (''Commission'') the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Amex. On February 22, 2006, Amex filed Amendment No. 1 to the proposed rule change.[3] The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to add new Section 127 and amend Sections 101, 401, 402, 710, 1002, and 1009 of the Amex Company Guide to increase the transparency of the process associated with staff determinations to deny the initial or continued listing of a company's securities on the Amex.

The text of the proposed rule change is available on the Amex's Web site at *http://www.amex.com,* at the Amex's principal office, and at the Commission's Public Reference Room.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Amex included statements concerning the purpose of and basis for the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Amex has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

Sections 101 and 1002 of the Amex Company Guide provide broad discretionary authority to the Exchange to deny initial or continued listing to a company, the condition or business of which raises public interest or other qualitative concerns that could undermine investor confidence in Amex listed securities. The Exchange proposes to add new Section 127 and amend Sections 101 and 1002 of the Amex Company Guide to clarify the circumstances in which the Exchange generally uses this authority and provide greater transparency to listed companies and applicants.[4]

The proposed rule and rule amendments would specify that the Exchange has authority to deny initial listing to an applicant, impose additional or more stringent criteria on initial or continued listing of a company's securities, or delist a company's securities under the following circumstances:

- The listed company or applicant, or an individual associated with the listed company or applicant, has a history of regulatory misconduct; [5]

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[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] Amendment No. 1 made technical changes to the rule text submitted in Exhibit 5.

[4] The Commission notes that this proposed rule change is substantially similar to a proposal submitted by the National Association of Securities Dealers, Inc. and approved by the Commission. *See* Securities Exchange Act Release No. 52342 (August 26, 2005), 70 FR 52456 (September 2, 2005) (SR–NASD–2004–125).

[5] Such individuals would typically be an officer, director, substantial security holder or consultant to the issuer. The Exchange proposes in new Section 127, Commentary .01 that an interest consisting of more than either 5% of the number of shares of common stock or 5% of the voting power outstanding of an issuer or party shall be considered a substantial interest and cause the holder of such an interest to be regarded as a substantial security holder. Telephone conversation between Jan Woo, Attorney, Division of Market Regulation, Commission, and Courtney McBride,