

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-58415; File No. PCAOB-2008-03)

August 22, 2008

Public Company Accounting Oversight Board; Order Approving Proposed Ethics and Independence Rule 3526, Communication with Audit Committees Concerning Independence, Amendment to Interim Independence Standards, and Amendment to Rule 3523, Tax Services for Persons in Financial Reporting Oversight Roles

I. Introduction

On April 24, 2008, the Public Company Accounting Oversight Board (the "Board" or the "PCAOB") filed with the Securities and Exchange Commission (the "SEC" or "Commission") proposed rule changes (PCAOB-2008-03) pursuant to Section 107(b) of the Sarbanes-Oxley Act of 2002 (the "Act"), relating to the Board's Ethics and Independence Rules. Notice of the proposed rule changes was published in the Federal Register on July 14, 2008.¹ The Commission received three comment letters relating to the proposed rule changes. For the reasons discussed below, the Commission is granting approval of the proposed rule changes.

II. Description of Proposed Rule Changes

Section 103(a) of the Act directs the PCAOB to establish auditing and related attestation standards, quality control standards, and ethics standards to be used by registered public accounting firms in the preparation and issuance of audit reports as required by the Act or the rules of the Commission.

In connection with its standards-setting function, the Board adopted in 2003 on an initial, transitional basis five temporary rules that incorporate the pre-existing professional standards of auditing, attestation, quality control and ethics and

¹ See SEC Release No. 34-58121 (Jul. 9, 2008); 73 FR 40418 (Jul. 14, 2008).

independence (the “interim standards”).² The interim standards include Independence Standards Board Standard No. 1, Independence Discussions with Audit Committees (“ISB No. 1”), ISB Interpretation 00-1, The Applicability of ISB Standard No. 1 When “Secondary Auditors” Are Involved in the Audit of a Registrant, and ISB Interpretation 00-2, The Applicability of ISB Standard No. 1 When “Secondary Auditors” Are Involved in the Audit of a Registrant, An Amendment of Interpretation 00-1.

On April 22, 2008, the PCAOB adopted proposed Ethics and Independence Rule 3526, Communication with Audit Committees Concerning Independence, which supersedes ISB No. 1, ISB Interpretation 00-1 and ISB Interpretation 00-2, and a proposed amendment to Rule 3523, Tax Services for Persons in Financial Reporting Oversight Roles, so that it will no longer apply to the provision of tax services to persons in financial reporting oversight roles during the portion of the audit period that precedes the professional engagement period.

Proposed Rule 3526, Communication with Audit Committees Concerning Independence, is intended to build on the communication requirements in interim standard ISB No. 1 and provide audit committees with information that may be important to its determination about whether to hire a registered public accounting firm as the company’s auditor. ISB No. 1 currently provides that, at least annually, an auditor shall: (a) 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; (b) confirm

² The Commission approved the PCAOB's adoption of the interim standards in Release No. 34-47745 (April 25, 2003); 68 FR 23335 (May 1, 2003).

in the letter that, in its professional judgment, it is independent of the company within the meaning of the “Securities Acts administered by the” SEC; and (c) discuss the auditor's independence with the audit committee.

Similar to ISB No. 1, the new rule requires a registered firm on at least an annual basis after becoming the issuer’s auditor to make a similar written communication and also affirm to the audit committee of the issuer, in writing, that the firm is independent. The PCAOB adopted this new rule in part because it believed that the accounting firm should discuss with the audit committee before accepting an initial engagement pursuant to the standards of the PCAOB any relationships the accounting firm has with the issuer that may reasonably be thought to bear on its independence. The new rule also includes a new requirement for the firm to document the substance of its discussion with the audit committee.

The PCAOB adopted Ethics and Independence Rules Concerning Independence, Tax Services and Contingent Fees³ on July 26, 2005.⁴ These rules included, among others, Rule 3523, which added to the list of services an audit firm is prohibited from providing its audit clients in order to maintain its independence by prohibiting audit firms from providing any tax service to any person who fills a financial reporting oversight role at an audit client, or an immediate family member of such individual, unless such person is in that role solely because he or she is a member of the board of directors or similar management governing body. The Board adopted certain technical amendments to the

³ PCAOB Release No. 2005-014.

⁴ On August 2, 2005, the PCAOB submitted its proposed rules to the Commission for approval.

rules on November 22, 2005 and adopted an additional amendment, delaying the implementation schedule for Rule 3523,⁵ on March 28, 2006.⁶

Rule 3523, as originally adopted, applies to all tax services performed for persons in a financial reporting oversight role during the “audit and professional engagement period.” The PCAOB’s definition of the term “audit and professional engagement period” is consistent with the Commission’s independence rules. The “audit period” is the period covered by any financial statements being audited or reviewed.⁷ The “professional engagement period” is the period beginning when the accounting firm either signs the initial engagement letter or begins audit procedures, whichever is earlier, and ends when the audit client or the accounting firm notifies the Commission that the client is no longer that firm’s audit client.⁸

Rule 3523 relates to services provided to individuals and not the audit clients. The Board adopted Rule 3523 because "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."⁹ In discussing this concern, however, the Board's release did not explore whether the provision of these tax services during the audit period but before becoming the auditor of record presents the same appearance issues as the auditor's provision of such services while serving as the auditor of record. In addition, while the Board received comment on this rule, commenters did not explicitly address this matter. Since

⁵ PCAOB Release No. 2006-001.

⁶ The March 28, 2006 amendment was adopted after the Commission published the proposed rules for comment.

⁷ PCAOB Rule 3501(a)(iii)(1).

⁸ PCAOB Rule 3501(a)(iii)(2).

⁹ PCAOB Release No. 2005-014 .

the PCAOB did not solicit comments relating to this matter, it adopted an amendment to the rule delaying the implementation of this part of the rule and issued a concept release to solicit comments to determine whether restrictions during this period unreasonably limit issuers' ability to change audit firms. On December 14, 2006, the Commission issued a notice of the PCAOB's rule amendment for Rule 3523, as it applies to tax services provided during the period subject to the audit but before the professional engagement period, so that the Board could revisit this aspect of the rule.¹⁰

On April 3, 2007, the Board issued that concept release.¹¹ The Board also adopted a rule amendment further delaying the implementation of Rule 3523 to apply to tax services provided on or before July 31, 2007 when those services are provided during the audit period and are completed before the professional engagement period begins.

On July 24, 2007, the Board proposed an amendment to Rule 3523¹² to exclude the portion of the audit period that precedes the beginning of the professional engagement period, as well as a new ethics and independence rule regarding communication with audit committees. Concurrent with issuing the proposed rule and rule amendment, the Board also adopted a rule amendment to further delay the implementation of Rule 3523 to apply to tax services provided on or before April 30, 2008 when those services are provided during the audit period and are completed before the professional engagement period begins.

On April 22, 2008, the Board adopted the amendment to PCAOB Rule 3523 to exclude the portion of the audit period that precedes the beginning of the professional

¹⁰ PCAOB Release No. 2006-006.

¹¹ PCAOB Release No. 2007-001.

¹² PCAOB Release No. 2007-008.

engagement period and a rule amendment to further delay the implementation date for that portion of Rule 3523 until December 31, 2008.

The proposed amendment to PCAOB Rule 3523 provides that the Board will not apply Rule 3523 to tax services when those services are provided during the audit period and are completed before the professional engagement period begins. Rule 3523 continues to apply to tax services provided during the professional engagement period.

Pursuant to the requirements of Section 107(b) of the Act and Section 19(b) of the Securities Exchange Act of 1934 (the “Exchange Act”), the Commission published the PCAOB’s proposed Ethics and Independence Rule 3526, Communication with Audit Committees Concerning Independence, conforming amendments to its interim standard ISB No. 1 and two related interpretations, and amendment to Rule 3523, Tax Services for Persons in Financial Reporting Oversight Roles for public comment in the Federal Register on July 14, 2008.¹³

III. Discussion

The Commission received two comment letters relating to proposed Rule 3526, both of which were generally supportive of the proposed rule.¹⁴ One of the firms, however, expressed concerns relating to the timing of the required communication of Rule 3526 and its effect on an auditor’s participation in the activities associated with an initial public offering. The firm also expressed concerns about the difference between the “audit and professional engagement period” referenced in the SEC’s independence rules and Rule 3526’s requirement to communicate matters that may have existed outside of this time period. The firm requested that the Commission include clarifying commentary

¹³ See SEC Release No. 34-58121 (Jul. 9, 2008); 73 FR 40418 (Jul. 14, 2008).

¹⁴ Ernst & Young LLP and Deloitte & Touche LLP.

in its approval order regarding these matters and urged the PCAOB to issue additional interpretive guidance to aid in the consistent application of the rules.

The PCAOB carefully considered the commenter's concerns before it adopted Rule 3526 and addressed those concerns in its adopting release. We do not believe that any clarifying commentary is necessary at this time. We encourage the PCAOB to carefully monitor the implementation of Rule 3526 and to provide appropriate guidance if it is needed in the future.

The Commission received three comment letters relating to the proposed amendment to Rule 3523. Two of the commenters were supportive of the amendment to Rule 3523.¹⁵ The other commenter¹⁶ expressed concern that Rule 3523 “put[s] a huge burden on smaller companies and larger tax firms” because some companies could have large numbers of employees and chances are that some of those employees could be receiving tax services from potential external auditors. While purportedly outside the scope of the proposed amendment, which in fact limits the scope of the rule to a narrower period of just the professional engagement period, it should also be noted that Rule 3523 applies only to persons in a financial reporting oversight role (FROR). This term is defined in PCAOB Rule 3501 as:

[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

¹⁵ Ernst & Young LLP and Deloitte & Touche LLP.

¹⁶ Matthew L. Garzia, Student, Business Management, Tappan, New York.

officer, controller, director of internal audit, director of financial reporting, treasurer, or any equivalent position.

Rule 3523 is further limited to exclude persons (i) who are in a FROR only because he or she serves as a member of the board of directors or similar management or governing body of the audit client, (ii) who are in FROR at affiliates if the affiliate's financial statements are immaterial or audited by a different auditor and (iii) who received tax services before being hired or promoted into a FROR if the services are completed on or before 180 days after the hiring or promotion event.

The PCAOB is not proposing to change the persons subject to Rule 3523 in its proposing amendment. The PCAOB gave careful consideration to the issues raised by the commenter prior to Rule 3523's adoption by the Board.

PCAOB Rules 3526 and 3523, including the proposed amendment to Rule 3523 and the conforming amendments to the interim standards, are a reasonable exercise of the Board's rule-making authority under the Act.

IV. Conclusion

On the basis of the foregoing, the Commission finds that the PCAOB's proposed Ethics and Independence Rule 3526, Communication with Audit Committees Concerning Independence, conforming amendments to its interim standard ISB No. 1 and two related interpretations, and amendment to Rule 3523, Tax Services for Persons in Financial Reporting Oversight Roles, are consistent with the requirements of the Act and the securities laws and are necessary and appropriate in the public interest and for the protection of investors.

IT IS THEREFORE ORDERED, pursuant to Section 107 of the Act and Section 19(b)(2) of the Exchange Act, that the proposed rule changes (File No. PCAOB-2008-03) be, and hereby are, approved.

By the Commission.

Florence E. Harmon
Acting Secretary