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AICPA

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

AICPA Professional Standards

Volume 1

U.S. Auditing Standards—AICPA

U.S. Auditing Standards—PCAOB

Attestation Standards

As of June 1, 2004

PC**PUBLIC COMPANY ACCOUNTING
OVERSIGHT BOARD STANDARDS
AND AUDITS OF PUBLIC COMPANIES**

The Sarbanes-Oxley Act (Act) authorizes the Public Company Accounting Oversight Board (PCAOB) to establish auditing and related attestation, quality control, ethics, and independence standards to be used by registered public accounting firms in the preparation and issuance of audit reports for entities subject to the Act or the rules of the Securities and Exchange Commission (Commission). Accordingly, public accounting firms registered with the PCAOB are required to adhere to all PCAOB standards in the audits of issuers, as defined by the Act, and other entities when prescribed by the rules of the Commission.

TABLE OF CONTENTS*Section*

110	Establishment of Interim Professional Auditing Standards
	Summary
	Board Contacts
	A. Overview of the Interim Professional Auditing Standards
	1. Interim Auditing Standards
	2. Interim Attestation Standards
	3. Interim Quality Control Standards
	4. Interim Ethics Standards
	5. Interim Independence Standards
	B. Effective Date for the Interim Professional Auditing Standards and Procedure for Commission Approval
	Appendix 1—Rules Relating to Interim Professional Auditing Standards
	RULE 3200T. Interim Auditing Standards
	RULE 3300T. Interim Attestation Standards
	RULE 3400T. Interim Quality Control Standards
	RULE 3500T. Interim Ethics Standards
	RULE 3600T. Interim Independence Standards

Section

110	Establishment of Interim Professional Auditing Standards—continued Appendix 2—Section-by-Section Analysis of Rules Relating to Interim Professional Auditing Standards Rule 3200T—Interim Auditing Standards Rule 3300T—Interim Attestation Standards Rule 3400T—Interim Quality Control Standards Rule 3500T—Interim Ethics Standards Rule 3600T—Interim Independence Standards
120	Compliance With Auditing and Related Professional Practice Standards—Advisory Groups Summary Public Comment Board Contacts A. Compliance With the Board’s Auditing and Related Professional Standards B. Establishment of Advisory Groups and Ad Hoc Task Forces 1. Authority 2. Role, Size and Composition 3. Nominations of SAG Members 4. Qualifications 5. Term 6. Conditions of Membership 7. Meetings and Board Relations Appendix 1—Rules Relating to Auditing and Related Professional Practice Standards and Advisory Groups Rule 1001. Definitions of Terms Employed in Rules Rule 3100. Compliance With Auditing and Related Professional Practice Standards Rule 3700. Advisory Groups Appendix 2—Section-by-Section Analysis of Rules Relating to Auditing and Related Professional Practice Standards and Advisory Groups Rules Relating to Auditing and Related Professional Practice Standards Rule 1001—Definitions of Terms Employed in Rules Rule 3100—Auditing and Related Professional Practice Standards Applicable to Registered Public Accounting Firms Rules Relating to Advisory Groups Rule 3700—Advisory Groups

Section

130	Auditing Standard No. 1—References in Auditors’ Reports to the Standards of the Public Company Accounting Oversight Board
	Summary
	Board Contacts
	A. Description of Auditing Standard No. 1
	B. Public Comment Process and Board Responses
	1. Transitional Issues
	2. Applicable Standards of the PCAOB
	3. Reference to GAAS
	4. References to Country of Origin and Issuing Office
	5. Other Auditors
	6. Applicability to Non-U.S. Firms Not Yet Registered With the Board
	7. Application of Auditing Standard No. 1 to Audit Reports in Connection With Initial Public Offerings
	Appendix—Auditing Standard No. 1—References in Auditors’ Reports to the Standards of the Public Company Accounting Oversight Board
	Illustrative Reports

[The next page is 2421.]

PC Section 110

Establishment of Interim Professional Auditing Standards

PCAOB Release No. 2003-006
April 18, 2003

Summary:

The Public Company Accounting Oversight Board (“Board” or “PCAOB”) has established interim standards of auditing, attestation, quality control, ethics, and independence (“Interim Professional Auditing Standards”). Section 103(a) of the Sarbanes-Oxley Act of 2002 (“Act”) provides that the Board shall, by rule, establish auditing and related attestation, quality control, and ethics standards to be used by registered public accounting firms in the preparation and issuance of audit reports. Section 103(b) authorizes the Board to adopt rules relating to auditor independence. The Board’s Interim Professional Auditing Standards were promulgated by various other bodies and pre-date the determination of the Securities and Exchange Commission (“Commission”), under Section 101(d), that the Board is capable of carrying out its responsibilities under the Act. Unlike other Rules of the Board, under Section 103(a)(3)(B) of the Act, the Board’s Interim Professional Auditing Standards “shall be separately approved by the Commission at the time of the determination, without regard to the procedures required by Section 107” of the Act regarding rulemaking.

This release describes the standards that the Board has adopted as Interim Professional Auditing Standards on an initial, transitional basis in order to assure continuity and certainty in the standards that govern audits of public companies. They will remain in effect while the Board conducts a review of standards applicable to registered public accounting firms, as discussed in PCAOB Release No. 2003-005. Based on this review, the Board may modify, repeal, replace or adopt permanently the Interim Professional Auditing Standards, or any part thereof, by rulemaking according to the Board’s procedures for the establishment of professional auditing standards and subject to Commission approval.

Board Contacts:

Gordon Seymour, Acting General Counsel (202/207-9034; seymourg@pcaobus.org), or Samantha Ross, Special Counsel to the Acting Chairman (202/207-9093; ross@pcaobus.org).

* * * * *

The Board has adopted Interim Professional Auditing Standards to govern the conduct of audits of public companies (i.e., “issuers” as defined in the Act). The Act provides that “[p]re-existing standards of designated professional groups of

accountants may be adopted during the Board's transitional period,¹ i.e., before the Commission's determination, under Section 101(d), that the Board is "organized and has the capacity to carry out the requirements of Title I" of the Act. Specifically, Section 103(a)(3)(B) and 103(a)(3)(A)(i) of the Act provide for the Board to adopt, as initial or transitional standards, "any portion of any statement of auditing standards or other professional standards" that satisfy the requirements of Section 103(a)(1) of the Act. These interim standards are to be "separately approved by the Commission at the time of the determination, without regard to the procedures required by Section 107" of the Act regarding rulemaking, which will govern the Board's permanent standards.²

Despite the need to adopt these existing standards on an initial, transitional basis in order to assure continuity and certainty in the standards that govern audits of public companies, the Board has not determined whether it would be appropriate to include any of the Interim Professional Auditing Standards as permanent Board standards. In order to make that determination, the Board will establish a schedule and procedure for the review of all Interim Professional Auditing Standards.³ The objective of that review will be to determine, on a standard-by-standard basis, whether the Interim Professional Auditing Standards should become permanent standards of the Board, should be repealed, or should be modified. As the review of each interim standard is completed, the Board will adopt that standard as a permanent Professional Auditing Standard, with or without modifications, will repeal the standard, or will take any other appropriate action regarding the standard.

The Interim Professional Auditing Standards consist of five rules (Rules 3200T, 3300T, 3400T, 3500T, and 3600T). Appendices 1 and 2 to this release contain, respectively, the text of these rules and a section-by-section analysis of the rules. Section A of this release provides an overview of the Interim Professional Auditing Standards and of the Board's reasons for adopting these standards. Section B of this release describes the effective date of the Interim Professional Auditing Standards and the procedure for Commission approval of these standards.

A. Overview of the Interim Professional Auditing Standards

1. Interim Auditing Standards

Auditors of public companies that issue securities are required to provide audit reports that "state whether the audit was made in accordance with generally accepted auditing standards" ("GAAS").⁴ The Commission's Division of Corporation Finance will not accept an audit report on the financial statements of an issuer unless the report states that the audit to which it relates was conducted in accordance with GAAS in the United States.⁵

¹ See S. Rep. No. 107-205, at 8 (2002).

² Section 103(a)(3)(B) of the Act. Section 107(b)(2) of the Act provides that "[n]o rule of the Board shall become effective without prior approval of the Commission . . . , other than as provided in section 103(a)(3)(B) with respect to initial or transitional standards."

³ See PCAOB Release No. 2003-005 (April 18, 2003).

⁴ See Regulation S-X, § 2-02, 17 C.F.R. § 210.2-02.

⁵ "All financial statements filed with the SEC are required to be audited in accordance with US GAAS, with an explicit statement of that fact in the auditor's report." See Division of Corporation Finance Current Accounting and Disclosure Issues (August 31, 2001), <http://www.sec.gov/divisions/corpfina/acctdisc.htm>.

Before the enactment of the Act, U.S. GAAS were established by the American Institute of Certified Public Accountants (“AICPA”). General standards on auditing, as well as standards relating to audit field work and audit reports, were approved and adopted by the membership of the AICPA, and amended by the AICPA’s Auditing Standards Board (“ASB”). In addition, the ASB has developed and issued 101 Statements of Auditing Standards (“SAS”) through a process that has included deliberations in public meetings, public exposure of draft statements, and adoption of statements approved by the ASB.⁶ GAAS also require an auditor to “be aware of and consider” certain AICPA interpretive publications, such as auditing Interpretations of the SASs, auditing guidance included in AICPA Audit and Accounting Guides, and AICPA auditing Statements of Position.⁷

Subject to the Commission’s oversight authority, the Act gives the Board the exclusive, statutory power to establish and amend Professional Auditing Standards to be used by registered public accounting firms in the preparation and issuance of audit reports.⁸ The Board’s Professional Auditing Standards supercede standards established by professional organizations, with respect to the preparation or issuance of audit reports on the financial statements of issuers. In Release No. 2003-005, the Board announced its intention to establish Professional Auditing Standards through an open process in which the accounting profession, the preparers of financial statements, the investor community, and others will have the opportunity to participate. The Board also announced in that release a plan to review existing GAAS and, when appropriate, change or establish new GAAS.

In order to assure continuity and certainty in the standards that govern audits of public companies during the Board’s review, the Board has determined that GAAS proposed and promulgated by the AICPA and the ASB, as they existed on April 16, 2003, should be adopted as Interim Auditing Standards, pursuant to Section 103(a)(3)(B). Accordingly, the Board has adopted Rule 3200T to require that registered public accounting firms comply with its Interim Auditing Standards in the performance of audits, or interim reviews,⁹ of the financial statements of issuers. The Board intends that these GAAS continue to have the same authority they have currently unless and until the Board supercedes them.

⁶ See SAS No. 95, Codification of Statements on Auditing Standards (“Codification”), AU § 150.03 (AICPA 2002).

⁷ In addition, SAS No. 95 also refers to other auditing publications, such as articles in the *Journal of Accountancy* and other professional journals, including publications by state CPA societies, textbooks, and guidebooks, that have contributed to the development of GAAS. Before applying the guidance in an “other auditing publication,” an auditor “should be satisfied that, in his or her judgment, it is both relevant to the circumstances of the audit and appropriate.” SAS No. 95, Codification at AU § 150.08.

⁸ Section 3(c)(2) of the Act provides that “[n]othing in this Act or the rules of the Board shall be construed to impair or limit . . . the authority of the Commission to set standards for accounting or auditing practices or auditor independence, derived from other provisions of the securities laws or the rules or regulations thereunder, for purposes of the preparation and issuance of any audit report, or otherwise under applicable law.”

⁹ Interim reviews of financial information are integrally related to audits. See generally SAS No. 100. For example, SAS No. 100 makes clear that the general standards on auditing discussed in SAS No. 95 “are applicable to a review of interim financial information.” See id. at ¶ 1; see also id. at ¶¶ 12-13 (requiring new auditor conducting initial review of interim financial information to perform procedures, including making inquiries and reviewing the work papers of predecessor auditor and obtaining knowledge of entity’s internal controls).

2. Interim Attestation Standards

Section 103(a)(1) authorizes the Board to establish “auditing and related attestation standards.”¹⁰ Consistent with the Interim Auditing Standards, the Board’s Rule 3300T designates the Statements on Standards for Attestation Engagements (“SSAE”) and related Interpretations and Statements of Position adopted by the ASB, as they existed on April 16, 2003, as the Board’s Interim Attestation Standards. Accordingly, registered public accounting firms must comply with those SSAEs that are related to the preparation or issuance of an audit report on the financial statements of an issuer.¹¹

3. Interim Quality Control Standards

Section 103(a)(1) authorizes the Board to establish quality control standards for registered public accounting firms. Until enactment of the Act, the ASB’s Statements on Quality Control Standards (“SQCS”) were the primary source of such standards.¹² In addition, public accounting firms that are members of the AICPA’s SEC Practice Section have committed to satisfying a number of other quality control-related requirements. Consistent with the Interim Auditing Standards and the Interim Attestation Standards, the Board’s Rule 3400T designates the Statements on Quality Control Standards adopted by the ASB, as they existed on April 16, 2003, as the Board’s Interim Quality Control Standards.

Rule 3400T also designates certain AICPA SEC Practice Section membership requirements as additional Interim Quality Control Standards.¹³ It should be noted that the Board is not adopting as interim standards the entirety of the AICPA SEC Practice Section’s membership requirements.¹⁴ Further, because the Board intends the Interim Quality Control Standards to preserve existing standards as they apply currently, consistent with Section 103(a)(3) of the Act, those Interim Quality Control Standards adapted from the AICPA SEC Practice Section requirements apply only to those firms that are members of the AICPA SEC Practice Section.¹⁵ The requirements incorporated in Rule 3400T, which are described in more detail in Appendix 2, related to the following matters—

¹⁰ Section 2(a)(10) of the Act also defines Professional Standards to include “standards for attestation engagements . . . that the Board or the Commission determines . . . relate to the preparation or issuance of audit reports for issuers.”

¹¹ Rule 3300T.

¹² See SAS 25, Codification at AU § 161 (requiring accounting firms to have quality controls for their audit practices). The ASB’s standards define quality control as “a process to provide the firm with reasonable assurance that its personnel comply with applicable professional standards and the firm’s standards of quality.” See System of Quality Control for a CPA Firm’s Accounting and Auditing Practice, AICPA Professional Standards (“Professional Standards”), QC § 20.03 (AICPA 2002). The ASB’s standards further set forth five broad elements of appropriate quality control in a public accounting firm, which relate to maintaining independence, integrity, and objectivity; managing personnel; establishing guidelines for accepting and continuing clients; performing engagements; and monitoring the existing quality control policies and procedures. Professional Standards at QC § 20.07.

¹³ AICPA SEC Practice Section Reference Manual, § 1000.08(d), (f), (l), (m), (n)(1) and (o).

¹⁴ For example, the Board is not adopting those SECPS membership requirements that require each member of the firm to be a member of the AICPA or that require member firms to submit to peer reviews, to report information to the SECPS or to the AICPA’s quality control inquiry committee, or to pay dues to the SECPS. See AICPA SEC Practice Section Reference Manual, § 1000.08(a), (c), (g), (j), (k) and (p). Nor is the Board adopting those SECPS membership requirements that have been superceded by statute or by Commission or Board rule.

¹⁵ In the future the Board may, by rulemaking and pursuant to its standards-setting procedures, extend the AICPA SEC Practice Section requirements to other registered public accounting firms.

- Continuing professional education of audit firm personnel;
- Concurring partner review of the audit report and the financial statements of Commission registrants;¹⁶
- Communication by written statement to all professional personnel of firm policies and procedures on the recommendation and approval of accounting principles, present and potential client relationships, and the types of services provided;
- Notification of the Commission of resignations and dismissals from audit engagements for Commission registrants;
- Audit firm obligations with respect to the policies and procedures of correspondent firms and of other members of international firms or international associations of firms; and
- Policies and procedures to comply with applicable independence requirements.

4. Interim Ethics Standards

Section 103(a)(1) authorizes the Board to establish ethics standards.¹⁷ The Board's Rule 3500T designates the provisions of the AICPA's Code of Professional Conduct on integrity and objectivity, as Interim Ethics Standards.¹⁸ Accordingly, registered public accounting firms must comply with the AICPA's Code of Professional Conduct Rule 102, and interpretations and rulings thereunder, as in existence as of the date of this release.¹⁹ Consistent with the other interim standards adopted by the Board, these ethical standards continue to have the same authority they have currently unless and until the Board supercedes them.

5. Interim Independence Standards

Section 103(b) of the Act authorizes the Board to "establish such rules 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 this Act."²⁰ The Board has adopted Interim Independence Standards, based on the provisions of the AICPA's Code of Professional Conduct regarding independence and

¹⁶ SECPS membership requirement (f) sets forth the Practice Section's concurring review requirements, which the Board has adopted as part of its Interim Quality Control Standards. See AICPA SEC Practice Section Reference Manual, § 1000.08(f). Requirement (f) also permitted the AICPA "peer review committee [to] authorize alternative procedures where this requirement cannot be met because of the size of the member firm." The Board has not adopted this part—the second sentence—of SECPS membership requirement (f). Under Section 103(a)(3)(A)(i), the Board "may adopt as its rules . . . any portion of any statement of auditing standards or other professional standards that the Board determines" satisfy the Act's requirements. The Board does, however, intend to permit requests for similar relief to be sought from the Board.

¹⁷ Section 2(a)(10)(B) of the Act also defines Professional Standards to include "ethical and competency standards . . . that the Board or the Commission determines . . . relate to the preparation or issuance of audit reports for issuers."

¹⁸ Professional Standards at ET §§ 102 and 191.

¹⁹ Rule 3500T.

²⁰ Title II of the Act addresses auditor independence. In addition, Section 2(a)(10) of the Act defines "Professional Standards" to include "independence standards (including rules implementing title II) that the Board or the Commission determines . . . relate to the preparation or issuance of audit reports for issuers."

existing standards and interpretations of the Independence Standards Board. Rule 3600T requires registered public accounting firms to comply with these independence standards in connection with the audit of any Commission registrant.

On January 28, 2003, the Commission adopted final rules to strengthen requirements regarding auditor independence and enhance disclosure regarding fees paid to auditors and otherwise to strengthen the Commission's existing auditor independence rules.²¹ These rules were designed to implement provisions of the Act. All registered public accounting firms are required to comply with Commission rules, and the Board's Interim Independence Standards do not supplant the Commission's independence rules. To the extent that the Commission's rules are more restrictive—or less restrictive—than the Board's Interim Independence Standards, registered public accounting firms must comply with the more restrictive requirements. The note to Rule 3600T clarifies this point.

B. Effective Date for the Interim Professional Auditing Standards and Procedure for Commission Approval

Under Section 103(a)(3)(B) of the Act, the Board's Interim Professional Auditing Standards "shall be separately approved by the Commission at the time of [the] determination" of the Commission under Section 101(d) of the Act that the Board has the capacity to carry out the requirements of Title I of the Act. This determination is expected to be made no later than April 26, 2003.²² The Interim Professional Auditing Standards shall be effective as of the date of the Commission's approval of them, which, accordingly, is expected to be no later than April 26, 2003.

* * * * *

On the 16th day of April, in the year 2003, the foregoing was, in accordance with the bylaws of the Public Company Accounting Oversight Board,

ISSUED BY THE BOARD.

/s/ J. Gordon Seymour

J. Gordon Seymour
Acting Secretary

April 16, 2003

APPENDICES:

1. Rules Relating to Interim Professional Auditing Standards
2. Section-by-Section Analysis of Rules Relating to Interim Professional Auditing Standards

²¹ See SEC, Strengthening the Commission's Requirements Regarding Auditor Independence, Securities Act Release No. 33-8183, 68 Fed. Reg. 6,006 (Jan. 28, 2003), as amended by Securities Act Release No. 33-8183A, 68 Fed. Reg. 15,354 (March 26, 2003).

²² Section 101(d) of the Act requires the Board to take such actions as are necessary or appropriate to enable the Commission to make this determination no later than 270 days after the enactment of the Act, i.e., no later than April 26, 2003.

Appendix 1

Rules Relating to Interim Professional Auditing Standards

RULES OF THE BOARD

SECTION 7. PROFESSIONAL STANDARDS

RULE 3200T. Interim Auditing Standards.

In connection with the preparation or issuance of any audit report, a registered public accounting firm, and its associated persons, shall comply with generally accepted auditing standards, as described in the AICPA Auditing Standards Board's Statement of Auditing Standards No. 95, as in existence on April 16, 2003 (Codification of Statements on Auditing Standards, AU § 150 (AICPA 2002)), to the extent not superseded or amended by the Board. [As amended, effective April 28, 2004, by PCAOB Release No. 2003-26.]

Note: Under Section 102(a) of the Act, public accounting firms are not required to be registered with the Board until 180 days after the date of the determination of the Commission under section 101(d) that the Board has the capacity to carry out the requirements of Title I of the Act (the "mandatory registration date"). The Board intends that, during the period preceding the mandatory registration date, the Interim Auditing Standards apply to public accounting firms that would be required to be registered after the mandatory registration date and to associated persons of those firms, as if those firms were registered public accounting firms.

RULE 3300T. Interim Attestation Standards.

In connection with an engagement (i) described in the AICPA's Auditing Standards Board's Statement on Standards for Attestation Engagements No. 10 (Codification of Statements on Auditing Standards, AT § 101.01 (AICPA 2002)) and (ii) related to the preparation or issuance of audit reports for issuers, a registered public accounting firm, and its associated persons, shall comply with the AICPA Auditing Standards Board's Statements on Standards for Attestation Engagements, and related interpretations and Statements of Position, as in existence on April 16, 2003, to the extent not superseded or amended by the Board. [As amended, effective April 28, 2004, by PCAOB Release No. 2003-26.]

Note: The Board intends that, during the period preceding the mandatory registration date, the Interim Attestation Standards apply to public accounting firms that would be required to be registered after the mandatory registration date and to associated persons of those firms, as if those firms were registered public accounting firms.

RULE 3400T. Interim Quality Control Standards.

A registered public accounting firm, and its associated persons, shall comply with quality control standards, as described in—

- (a) the AICPA's Auditing Standards Board's Statements on Quality Control Standards, as in existence on April 16, 2003 (AICPA Professional Standards, QC §§ 20–40 (AICPA 2002)), to the extent not superseded or amended by the Board; and
- (b) the AICPA SEC Practice Section's Requirements of Membership (d), (f)(first sentence), (l), (m), (n)(1) and (o), as in existence on April 16,

2003 (AICPA SEC Practice Section Manual § 1000.08(d), (f), (j), (m), (n)(1) and (o)), to the extent not superseded or amended by the Board.

[As amended, effective April 28, 2004, by PCAOB Release No. 2003-26.]

Note: The second sentence of requirement (f) of the AICPA SEC Practice Section's Requirements of Membership provided for the AICPA's peer review committee to "authorize alternative procedures" when the requirement for a concurring review could not be met because of the size of the firm. This provision is not adopted as part of the Board's Interim Quality Control Standards. After the effective date of the Interim Quality Control Standards, requests for authorization of alternative procedures to a concurring review may, however, be directed to the Board.

Note: The Board intends that, during the period preceding the mandatory registration date, the Interim Quality Control Standards apply to public accounting firms that would be required to be registered after the mandatory registration date and to associated persons of those firms, as if those firms were registered public accounting firms.

RULE 3500T. Interim Ethics Standards.

In connection with the preparation or issuance of any audit report, a registered public accounting firm, and its associated persons, shall comply with ethics standards, as described in the AICPA's Code of Professional Conduct Rule 102, and interpretations and rulings thereunder, as in existence on April 16, 2003 (AICPA Professional Standards, ET §§ 102 and 191 (AICPA 2002)), to the extent not superseded or amended by the Board. [As amended, effective April 28, 2004, by PCAOB Release No. 2003-26.]

Note: The Board intends that, during the period preceding the mandatory registration date, the Interim Ethics Standards apply to public accounting firms that would be required to be registered after the mandatory registration date and to associated persons of those firms, as if those firms were registered public accounting firms.

RULE 3600T. Interim Independence Standards.

In connection with the preparation or issuance of any audit report, a registered public accounting firm, and its associated persons, shall comply with independence standards—

- (a) as described in the AICPA's Code of Professional Conduct Rule 101, and interpretations and rulings thereunder, as in existence on April 16, 2003 (AICPA Professional Standards, ET §§ 101 and 191 (AICPA 2002)), to the extent not superseded or amended by the Board; and
- (b) Standards Nos. 1, 2, and 3, and Interpretations 99-1, 00-1, and 00-2, of the Independence Standards Board, to the extent not superseded or amended by the Board.

[As amended, effective April 28, 2004, by PCAOB Release No. 2003-26.]

Note: The Board's Interim Independence Standards do not supercede the Commission's auditor independence rules. See Rule 2-01 of Reg. S-X, 17 C.F.R. 240.2-01. Therefore, to the extent that a provision of the Commission's rule is more restrictive—or less restrictive—than the Board's Interim Independence Standards, a registered public accounting firm must comply with the more restrictive rule.

Note: The Board intends that, during the period preceding the mandatory registration date, the Interim Independence Standards apply to public accounting firms that would be required to be registered after the mandatory registration date and to associated persons of those firms, as if those firms were registered public accounting firms.

Appendix 2

Section-by-Section Analysis of Rules Relating to Interim Professional Auditing Standards

The rules relating to interim professional auditing standards consist of PCAOB Rules 3200T, 3300T, 3400T, 3500T and 3600T. Each of the rules is discussed below.

Rule 3200T—Interim Auditing Standards

Rule 3200T provides that, in connection with the preparation or issuance of any audit report on the financial statements of an issuer, a registered public accounting firm shall comply with generally accepted auditing standards as described in the American Institute of Certified Public Accountants' ("AICPA") Auditing Standards Board's ("ASB") Statement on Auditing Standards ("SAS") No. 95, as in existence on April 16, 2003. SAS No. 95 describes the relative authority of various sources of generally accepted auditing standards. Specifically, SAS No. 95 describes the ten general, field work and reporting standards approved by the membership of the AICPA, and amended by the ASB, and the Statements on Auditing Standards approved by the ASB, as standards with which an auditor is required to comply.¹ As of April 16, 2003, 101 SASs had been issued by the ASB.

Statement of Auditing Standards No. 95 also provides that an "auditor should be aware of and consider" certain interpretive publications, such as the ASB's Interpretations of the SASs, auditing guidance included in AICPA Audit and Accounting Guides, and AICPA auditing Statements of Position. While these interpretive publications have not been accorded the same authority as the ten GAAS or the SASs, SAS No. 95 requires that, if an auditor does not comply with the guidance in these publications, "the auditor should be prepared to explain how he or she complied with the SAS provisions addressed by such auditing guidance." Finally, SAS No. 95 also recognizes that other auditing publications "may help the auditor understand and apply the SASs." The Board's Rule 3200T provisionally adopts this framework.

As the Note to Rule 3200T clarifies, under Section 102(a) of the Act, public accounting firms that want to continue to audit issuers are not required to be registered with the Board until 180 days after the date of the determination of the Commission under section 101(d) that the Board has the capacity to carry out the requirements of Title I of the Act (the "mandatory registration date"). The Board intends that, during the period preceding the mandatory registration date, the Interim Auditing Standards apply to public accounting firms that would be required to be registered after the mandatory registration date and to associated persons of those firms, as if those firms were registered public accounting firms.

Rule 3300T—Interim Attestation Standards

Rule 3300T governs the conduct of engagements that (i) are described in the ASB's Statement on Standards for Attestation Engagements No. 10 (Codification

¹ SAS No. 95, Codification of Statements on Auditing Standards, AU §§ 150.02-150.03. Statement of Auditing Standards No. 95 also provides that "[t]he auditor should be prepared to justify departures from the SASs."

of Statements on Auditing Standards, AT § 101.01), and (ii) relate to the preparation or issuance of audit reports for issuers. Registered public accounting firms involved in such engagements are required to comply with the ASB's Statements on Standards for Attestation Engagements, and related interpretations and AICPA Statements of Position, as in existence on April 16, 2003.

As the Note to Rule 3300T clarifies, the Board intends that, during the period preceding the mandatory registration date, the Interim Attestation Standards apply to public accounting firms that would be required to be registered after the mandatory registration date and to associated persons of those firms, as if those firms were registered public accounting firms.

Rule 3400T—Interim Quality Control Standards

Rule 3400T sets forth minimum quality control standards with which registered public accounting firms must comply, in order to ensure that registered public accounting firms, and their personnel, comply with applicable accounting and auditing (and other professional) standards. Through Rule 3400T, the Board has provisionally designated the Statements on Quality Control Standards proposed and issued by the ASB and certain AICPA SEC Practice Section ("SECPS") membership requirements, as they existed, and as they applied to SEC Practice Section members, on April 16, 2003, as the Board's Interim Quality Control Standards. Because the Board intends the Interim Quality Control Standards to preserve existing standards as they applied on April 16, consistent with Section 103(a)(3) of the Act, those Interim Quality Control Standards adapted from the AICPA SEC Practice Section requirements apply only to those firms that are members of the AICPA SEC Practice Section.²

The ASB's Statements on Quality Control Standards are published in the AICPA's Professional Standards, at QC Sections 20-40. The provisions of the AICPA's SECPS membership requirements that have been incorporated into the Board's Interim Quality Control Standards are Membership Requirements (d), (f) (first sentence), (l), (m), (n)(1) and (o), and referenced appendices, which are published in the AICPA's SEC Practice Section Reference Manual § 1000.08. The SECPS membership requirements that are incorporated into the Board's Interim Quality Control Standards provide as follows:

- Requirement (d) requires registered public accounting firms to "ensure that all professionals in the firm residing in the United States, including CPAs and non-CPAs, participate in at least 20 hours of qualifying continuing professional education (CPE) every year and at least 120 hours every three years. . . . [P]rofessionals who devote at least 25% of their time to performing audit, review or other attest engagements (excluding compilations), or who have the partner/manager-level responsibility for the overall supervision or review of any such engagements, must obtain at least 40% (eight hours in any one year and 48 hours every three years) of their required CPE in subjects relating to accounting and auditing."
- Requirement (f) requires registered public accounting firms to "establish policies and procedures that meet the requirements set forth in the SECPS Reference Manual, for a concurring review of the audit report and the financial statements by a partner other than the audit

² In the future the Board may, by rulemaking and pursuant to its standards-setting procedures, extend the AICPA SEC Practice Section requirements to other registered public accounting firms.

partner-in-charge of an SEC engagement before issuance of an audit report on the financial statements of an SEC engagement and before the re-issuance of such an audit report where the performance of subsequent events procedures is required by professional standards.” After the effective date of the Interim Quality Control Standards, requests for authorization of alternative procedures to a concurring review may be sought from the Board. Any such request should be directed to the attention of the Director of Registration and Inspection, 1666 K Street, N.W., Washington, D.C. 20006-2803.

- Requirement (l) requires registered public accounting firms to “communicate through a written statement to all professional firm personnel the broad principles that influence the firm’s quality control and operating policies and procedures on, as a minimum, matters related to the recommendation and approval of accounting principles, present and potential client relationships, and the types of services provided, and inform professional firm personnel periodically that compliance with those principles is mandatory.”
- Requirement (m) requires a registered public accounting firm that has been the auditor of an SEC registrant and has resigned, declined to stand for reelection, or been dismissed, to report the fact that the “relationship has ceased directly in writing to the former SEC client, with a simultaneous copy to the Office of the Chief Accountant of the Securities and Exchange Commission” by the end of the fifth business day following the firm’s determination that the relationship has ended, irrespective of whether or not the SEC registrant has reported the change in a timely-filed Form 8-K.
- Requirement (n)(1) requires registered public accounting firms that are “members of, correspondents with, or similarly associated with international firms or international associations of firms,” to “seek adoption of policies and procedures by the international organization or individual foreign associated firms that are consistent with the objectives set forth in Appendix K, SECPS § 1000.45.”
- Requirement (o) requires registered public accounting firms to ensure that they have “policies and procedures in place to comply” with applicable independence requirements. This requirement further specifically requires firms to establish independence policies covering relationships between the firm, its benefit plans, and its professionals, and restricted entities.

As the Note to Rule 3400T clarifies, the Board intends that, during the period preceding the mandatory registration date, the Interim Quality Control Standards apply to public accounting firms that would be required to be registered after the mandatory registration date and to associated persons of those firms, as if those firms were registered public accounting firms.

Rule 3500T—Interim Ethics Standards

Rule 3500T sets forth ethics standards for registered public accounting firms and their personnel. Through Rule 3500T, the Board has provisionally designated Rule 101 of the AICPA’s Code of Professional Conduct, and interpretations and rulings thereunder, as they existed on April 16, 2003, as the Board’s Interim Ethics Standards. Rule 101, and the AICPA’s interpretations and rulings thereunder, are published in AICPA Professional Standards, ET §§ 102 and 191 (AICPA 2002).

As the Note to Rule 3500T clarifies, the Board intends that, during the period preceding the mandatory registration date, the Interim Ethics Standards apply to public accounting firms that would be required to be registered after the mandatory registration date and to associated persons of those firms, as if those firms were registered public accounting firms.

Rule 3600T—Interim Independence Standards

Rule 3600T sets forth independence standards for registered public accounting firms and their personnel. Through Rule 3600T, the Board has provisionally designated Rule 101 of the AICPA's Code of Professional Conduct, and interpretations and rulings thereunder, as they existed on April 16, 2003, and Standards Nos. 1, 2 and 3, and interpretations 99-1, 00-1, and 00-2 of the Independence Standards Board ("ISB"), as the Board's Interim Independence Standards. Rule 101, and the AICPA's interpretations and rulings thereunder, are published in the AICPA's Professional Standards, at ET Sections 102 and 191. The ISB Standards and interpretations, which are made effective by the SEC's Policy Statement on the Establishment and Improvement of Standards Related to Auditor Independence (FR No. 50A, July 17, 2001), are currently available at www.cpaindependence.org.

The Board's Interim Independence Standards shall not be interpreted to supercede the Commission's independence requirements. Therefore, to the extent that a provision of the Commission's rule or policy is more restrictive—or less restrictive—than the Board's Interim Independence Standards, a registered public accounting firm shall comply with the more restrictive requirement.

As the Note to Rule 3600T clarifies, the Board intends that, during the period preceding the mandatory registration date, the Interim Independence Standards apply to public accounting firms that would be required to be registered after the mandatory registration date and to associated persons of those firms, as if those firms were registered public accounting firms.

[The next page is 2441.]

PC Section 120

Compliance With Auditing and Related Professional Practice Standards —Advisory Groups

PCAOB Release No. 2003-009
June 30, 2003

PCAOB Rulemaking
Docket Matter No. 004

Summary:

After public comment, the Public Company Accounting Oversight Board (“Board” or “PCAOB”) has adopted a Rule relating to compliance with the Board’s auditing and related professional practice standards and a Rule relating to the formation of advisory groups. Specifically, the Board has adopted Rule 3100, and a related definition that would appear in Rule 1001, and Rule 3700. Rule 3100 generally requires all registered public accounting firms to adhere to the Board’s auditing and related professional practice standards in connection with the preparation or issuance of any audit report for an issuer (as defined in the Sarbanes-Oxley Act of 2002 (the “Act”)) and in their auditing and related attestation practices. Rule 3700 governs the formation, composition and role of one or more advisory groups to assist the Board in formulating new auditing and related professional practice standards for registered public accounting firms. The Board will submit these Rules to the Securities and Exchange Commission (“Commission” or “SEC”) for its approval pursuant to Section 107 of the Act. These Rules will not take effect unless approved by the Commission pursuant to Section 107 of the Act. This Release also provides additional guidance regarding the number, size and composition of advisory groups and addresses certain qualifications that the Board may consider in selecting advisory group members and the terms and conditions of membership. Further, it provides guidance about the advisory group meetings, agendas, role of members and procedures that the Board believes is important to the functioning of advisory groups.

Public Comment:

The Board released for public comment proposed Rules on the establishment of auditing and other professional standards on April 18, 2003. The Board received 22 letters of comment.

Board Contacts:

Gordon Seymour, Acting General Counsel (202/207-9034; seymourg@pcaobus.org), Thomas Ray, Deputy Chief Auditor (202/207-9112; rayt@pcaobus.org), or Mary M. Sjoquist, Special Counsel to Board Member Gradison (202/207-9084; sjoquistm@pcaobus.org).

* * * * *

Section 103(a)(1) of the Act directs the Board 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, or as may be necessary or appropriate in the public interest or for the protection of investors. Similarly, Section 103(b) authorizes the Board to establish such rules as may be necessary or appropriate to implement the auditor independence requirements in, or as authorized under, Title II of the Act. While Section 103(a)(4) directs the Board to convene such expert advisory groups as may be appropriate to aid in standards-setting, it nevertheless affords the Board considerable discretion in determining the procedures by which it will develop and adopt auditing and related professional practice standards.¹

This Release announces the adoption of Rule 3100 (and a related definition) and Rule 3700. Rule 3100 requires all registered public accounting firms to adhere to the Board's auditing (and related attestation), quality control, and ethics standards, and its independence standards. Rule 3700 addresses the formation, composition, and other basic matters concerning advisory groups, which may be convened to aid in the Board's standards-setting process. In addition, as set forth in more detail below, the Board has determined to convene, at this time, one standing advisory group (the "SAG") to assist it in performing its standards-setting responsibilities.

Section A of this Release discusses the adoption of Rule 3100. Section B discusses the adoption of Rule 3700, and the establishment of the SAG and ad hoc task forces. The text of Rule 3100 (and a related definition) and Rule 3700 and a detailed discussion of the Rules are provided in Appendices 1 and 2 hereto, respectively.

The Board has reviewed all of the public comments received on the Rules as proposed in Release No. 2003-005. In response to these comments, Rule 3100 (and a related definition) and Rule 3700, as finalized, both clarify and modify certain aspects of the proposed Rules. Most importantly, the revisions to the original proposal are as follows—

- Instead of using the term Professional Auditing Standards as originally proposed, the defined term in Rule 1001 has been changed to Auditing and Related Professional Practice Standards;
- Rule 3700(c), Selection of Members of Advisory Groups, has been revised to clarify that the Board will accept nominations to the SAG, including self-nominations, from any person or organization rather than including a nonexclusive list of specific groups; and
- Rule 3700(e), Ethical Duties of Advisory Group Members, has been revised to make EC10 of the Board's Ethics Code applicable to members of the SAG with respect to any private publication or public statement about the Board or any advisory group or any of the activities of the Board or any advisory group.²

¹ The auditing and related attestation standards, quality control standards, and ethics standards over which the Board has authority under Section 103(a) of the Act, and the independence rules the Board is authorized to adopt under Section 103(b), are collectively referred to in this Release as "auditing and related professional practice standards." This term is defined in Rule 1001(a)(viii). The Board's proposed Rules and Release used the term "professional auditing standards." As discussed in more detail in Appendix 2 to this Release, because a number of commenters found this term confusing, the Board has decided to use the term "auditing and related professional practice standards" (hereinafter, "Standards").

² See PCAOB Release No. 2003-008 (June 30, 2003) which includes the entire text of the Board's Ethics Code.

A more detailed analysis of the Board's response to the comments on the proposed Rules is included in Appendix 2. The Board's Rules will be submitted to the Commission for approval. Pursuant to Section 107 of the Act, Board Rules do not take effect unless approved by the Commission.

A. Compliance With the Board's Auditing and Related Professional Standards

Section 103(a) of the Act directs the Board, by rule, 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, or as may be necessary or appropriate in the public interest or for the protection of investors." Section 103(b) of the Act also directs the Board to establish independence standards to implement, or as authorized under, Title II of the Act.³

As a corollary to the Board's exclusive, statutory authority to establish and amend Standards, all public accounting firms that are registered with the Board must comply with the Board's Standards. While this requirement is implicit in the Act, the Board has codified the obligation of registered firms to comply with the Board's Standards in Rule 3100. Any registered public accounting firm or person associated with such a firm that fails to adhere to applicable Board Standards may be the subject of a Board disciplinary proceeding in accordance with Section 105 of the Act.⁴ In general, the Board's Standards will apply to registered public accounting firms and their associated persons in connection with their audits of (and related attestations concerning) the financial statements of issuers, as defined in Section 2(a)(7) of the Act, and those firms' auditing and related attestation practices. A number of commenters suggested that this Rule was either beyond the Board's authority or would create the impression that it applied to areas outside the Board's authority. To address these concerns, commenters suggested adding language about the scope of the Board's authority to Rule 3100. After considering these comments, the Board has decided to adopt the Rule as proposed.

The Board recognizes its responsibility to oversee the audits of issuers, as that term is defined in the Act, and does not intend to suggest that registered public accounting firms and their associated persons must comply with the Board's Standards in auditing non-issuers. Rule 3100, however, requires registered public accounting firms and their associated persons to comply with all *applicable* Standards. Accordingly, if the Board's Standards do not apply to an engagement or other activity of the firm, Rule 3100, by its own terms, does not apply to that engagement or activity.

³ See also Report of the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, on S. 2673, S. Rep. No. 107-205 (July 26, 2002) ("The Committee has concluded that the Board's plenary authority in this area is essential for the Board's effective operation, a position taken during the hearings by a number of witnesses . . ."). Board Rules adopting or modifying auditing and related professional practice standards require approval by the Commission. In addition, the Board recognizes that the Commission may also establish professional standards applicable to accountants that practice before it and audit reports filed with it and that the Commission has the authority to institute proceedings to amend the Board's Rules, including those that establish auditing and related professional practice standards. See Sections 2(a)(10), 3(c)(2), and 107(b)(5) of the Act.

⁴ In addition, the Act provides that any violation of the Board's Rules is to be treated for all purposes in the same manner as a violation of the Securities Exchange Act of 1934, 15 U.S.C. 78a et seq., or the rules and regulations issued thereunder, and any person violating the Board's Rules "shall be subject to the same penalties, and to the same extent, as for a violation of [the Exchange] Act or such rules or regulations." Section 3(b)(1) of the Act.

Authorities other than the Board may nevertheless require that accounting firms or individual auditors comply with the Board's Standards in the conduct of audits of (or attestations concerning) the financial statements of non-issuers.⁵ In that event, those authorities may enforce the Board's Standards pursuant to their own processes.

B. Establishment of Advisory Groups and Ad Hoc Task Forces

While the Board will, by rule, establish Standards, it recognizes that the development of such Standards should be an open, public process in which investors, the accounting profession, the preparers of financial statements, and others will have the opportunity to participate. To this end, as discussed in PCAOB Release No. 2003-005 (April 18, 2003), the Board intends to provide for a public comment process on proposed standards.⁶ The Board's staff will, of course, be actively involved in the standards-setting process, but the Board also encourages proposals and recommendations on its standards-setting agenda and standards development projects from the public. Moreover, in order to obtain the advice of a broad range of experts, the Board has determined to form an advisory group, the SAG, which may be divided into sub-groups by the Board if the need for specialized advice arises. Finally, the Board may also establish one or more ad hoc task forces to assist the staff with the drafting of technical language, among other things.

1. Authority

Section 103(a)(4) of the Act provides that the Board shall "convene, or authorize its staff to convene, such expert advisory groups as may be appropriate . . . to make recommendations concerning the content (including proposed drafts) of auditing, quality control, ethics, independence, or other standards required to be established under this section." The Board has decided initially that it is likely to exercise this authority by convening the SAG to participate in the standards-setting process. Rule 3700 addresses the formation, composition, and other basic matters concerning advisory groups, including the SAG.

2. Role, Size and Composition

The role of the SAG will be to assist the Board in *reviewing* existing Standards, in *evaluating* proposed Standards recommended by Board staff, Board-formed technical task forces or others and *recommending* to the Board new or amended Standards. The role of the SAG will not ordinarily include technical drafting (which will be performed by the Board's staff, with the assistance of ad hoc task forces, when necessary). Instead, the Board will look to the SAG to provide advice and insight as to the need to formulate new Standards or change existing Standards and opinions on the impact of proposed new or changed Standards.

⁵ Cf. Section 209 of the Act (stating that "[i]n supervising nonregistered public accounting firms and their associated persons, appropriate State regulatory authorities should make an independent determination of the proper standards applicable . . .").

⁶ In response to PCAOB Release No. 2003-005, the Board received several comments relating to the process by which the Board will establish standards. While this release is intended to address only the adoption of Rules 3100 and 3700, the Board will nevertheless take these comments into consideration in its standards-setting work.

The Board contemplates that the SAG initially will have approximately 25 members. As noted above, the Board may, based on the circumstances of particular projects, prior to or after the formation of the SAG, form ad hoc task forces of specially qualified persons selected by the Board to assist it with specific projects. Members of any appointed ad hoc task force may or may not be members of the SAG.

The SAG will be composed of individuals with a variety of backgrounds, including practicing auditors, preparers of financial statements, investors (both individual and institutional), and others.⁷ In order to achieve this diversity, the Board expects that no one field of expertise will predominate among the SAG membership. Although SAG members may be employed or otherwise affiliated with particular organizations, the Board expects SAG members to serve in their individual capacities and not to serve as representatives of particular interests, groups or employers.

3. Nominations of SAG Members

In determining appointments to the SAG, the Board intends to solicit nominations, including self-nominations. Interested parties will have 45 days from the date of the Board's Notice ("Notice") to the public to submit nominations on a form which will be provided in the Notice. Interested parties who have submitted nominations prior to the publication of the Notice, will be sent nomination forms for completion at the time of publication of the Notice.

4. Qualifications

In evaluating nominations for the SAG, the Board will seek individuals with an interest in the quality of the audits of public companies. The Board may also consider certain factors in determining SAG appointments including but not limited to the following—

- a. SAG members will be individuals of integrity, with an understanding of the responsibilities for and the nature of financial disclosure required under the securities laws and the obligations of accountants with respect to the preparation of and issuance of audit reports with respect to such disclosures; and
- b. SAG members will have a working knowledge of one or more of the following subjects and a general understanding of the remaining subjects—
 - generally accepted auditing standards (as developed by previous auditing standards setting bodies and adopted by the Board as Standards and, in the future, as set from time to time by the Board);
 - generally accepted accounting principles;
 - the creation, audit or analysis of public financial statements;
 - public company corporate governance; and
 - other fields that the Board deems to be relevant.

⁷ The Board also anticipates appointing individuals from academia and state accounting regulators, among others, to the SAG.

5. Term

Unless the appointment is revoked for cause, as determined by the Board, or unless the SAG member voluntarily resigns from the SAG, membership on the SAG will be for a term of two years; provided, however, that approximately 50 percent of the initial members will be appointed for a three-year term to assure continuity. Members will not be limited in the number of terms that they may serve.

6. Conditions of Membership

Rule 3700(d) specifically states that members of the SAG will serve in their individual capacities and therefore may not delegate their duties, including attendance at meetings, as SAG members. In addition, each appointee to the SAG shall agree in writing to the following “conditions of membership” in order to avoid potential conflicts of interest and to assure that the Board’s standards-setting agenda is met—

- a. to serve on a voluntary basis without compensation from the Board;⁸
- b. to seek constructive resolutions to issues raised by the Board for the SAG;
- c. to act in the public interest in his or her individual capacity and not as a representative of any constituency;
- d. to attend at least 75 percent of all SAG meetings;⁹
- e. to agree to spend, at an expected minimum, between 50 and 100 hours per year on SAG matters or such reasonably greater amount of time as may be necessary to achieve the goals of the SAG and the Board;¹⁰
- f. to refrain from using his or her position on the SAG to influence Board members or Board staff on matters directly affecting that SAG member or his or her employer, business partners or clients;¹¹
- g. to recuse himself or herself, or otherwise withdraw from, consideration of any matter before the SAG or the Board directly affecting such SAG member, his or her employer, business partners or clients. If recusal or withdrawal is not practical in either such member’s or the Board’s opinion, such SAG member shall resign from the SAG;¹²

⁸ SAG members shall be entitled to reimbursement for documented reasonable travel expenses relating to participation in official SAG meetings or other SAG activities.

⁹ Attendance may be in person or by telephone or teleconference. SAG members who fail to participate in the minimum number of meetings shall be subject to removal by the Board unless excused from attendance by the Chair of the SAG for good reason.

¹⁰ During the first year of the SAG, members may expect to spend more than the minimum number of hours on SAG matters.

¹¹ SAG members are not precluded from appearing or practicing before the Board regarding matters generally affecting all issuers or registered public accounting firms, including, indirectly, the member, his or her employer, business partners or clients. Accordingly, a SAG member who is employed by a registered public accounting firm would be permitted to be involved in preparing a comment on a Board rule proposal that generally affects all issuers or registered public accounting firms.

¹² Matters generally affecting issuers or registered public accounting firms, even though affecting the SAG member, his or her employer, business partners or clients, shall not require the member to recuse or withdraw him or herself from consideration of the matter or to resign from SAG. The Board expects that most standards-setting projects will affect issuers (or categories of issuers) and registered public accounting firms and their associated persons in a generally similar manner; however, if a standard would have a unique or disproportionate effect on a particular issuer or firm, a SAG member employed by that issuer or firm would be required under Rule 3700 to recuse himself or herself.

- h. to be bound by EC3, EC8(a), EC9, and, with respect to any private publication or public statement regarding the Board or the SAG or any of the activities of the Board or the SAG, EC10 of the Board's Ethics code,¹³
- i. to annually certify his or her continuing compliance with "the conditions of membership;" and
- j. to agree to any such other provisions that the Board may deem necessary to avoid even the appearance of a conflict of interest.

7. Meetings and Board Relations

The Board has determined that the first Chair of the SAG will be the Board's Chief Auditor and Director of Professional Standards who will be a non-voting member of the SAG. The Board will approve the agenda for all annual, semi-annual or quarterly SAG meetings as set forth below. Agenda items may also be added where the Board determines that the assistance of the SAG is required in response to emerging issues or problems. The Chair will be responsible for preparing the meeting agenda, organizing and overseeing meetings, conference calls and related activities, acting as the general liaison to the Board and finalizing all submissions to the Board based on the SAG recommendations.

The SAG will hold an annual meeting to discuss the agenda presented to the SAG on the annual standards-setting process and related matters. The SAG will also hold a semi-annual meeting. Both the annual and the semi-annual meetings will be open to the public. Meetings of the SAG may also be held, at the direction of the Board or the Chair, during the intervening quarters. In addition, at the direction of the Chair, monthly meetings of the SAG may be held, by video or teleconference, for the Board's staff to report on new issues raised by the Board for the SAG's consideration and to discuss the status of pending issues. Final decisions on recommendations to the Board and related activities will be conducted at the annual, semi-annual, or other open meeting of the SAG.¹⁴ The meetings held in the quarters between the annual and semi-annual meeting, if any, and the monthly meetings will not generally be open to the public.

If so directed by the Chair of the SAG, the SAG may convene hearings, roundtable discussions or other fact-finding activities designed to assist the SAG in the development of recommendations on new or amended Standards or other recommendations to the Board.

Decisions on whether a recommendation should be made to the Board will be by a majority of the SAG members present in person or by video or teleconference. Recommendations from the SAG will be presented to the Board at an open meeting of the Board. Such recommendations will be provided in

¹³ In PCAOB Release No. 2003-008 (June 30, 2003), the Board clarified that for purposes of applying EC8(a) to SAG members, the SAG members shall not be considered to lack independence or objectivity with regard to SAG matters merely because they (or their employer, business partners or clients) are subject to the direct or indirect oversight of the Board.

¹⁴ The Board expects the SAG to make decisions in an efficient and speedy manner. To this end, the SAG need not defer decisions on recommendations for the annual or semi-annual open meetings. Rather, at the direction of the Chair, the SAG may make decisions on recommendations at any meeting, so long as it is open to the public in some manner, including, at the direction of the Chair, telephonically.

writing, including dissenting opinions, if any, by SAG members. The Board retains the exclusive authority to adopt, modify, or reject any SAG recommendation, in its sole discretion, in order to protect investors by improving the fairness and reliability of corporate disclosures as set forth in the Act.

* * * * *

On the 30th day of June, in the year 2003, the foregoing was, in accordance with the bylaws of the Public Company Accounting Oversight Board,

ADOPTED BY THE BOARD.

/s/ J. Gordon Seymour

J. Gordon Seymour
Acting Secretary

June 30, 2003

APPENDICES—

1. Rules Relating to Auditing and Related Professional Practice Standards and Advisory Groups
2. Section-by-Section Analysis of Rules Relating to Auditing and Related Professional Practice Standards and Advisory Groups

Appendix 1

Rules Relating to Auditing and Related Professional Practice Standards and Advisory Groups

RULES OF THE BOARD

SECTION 1. GENERAL PROVISIONS

Rule 1001. Definitions of Terms Employed in Rules.

When used in the Rules, unless the context otherwise requires:

(a)(viii) Auditing and Related Professional Practice Standards.

The term “auditing and related professional practice standards” means the auditing standards, related attestation standards, quality control standards, ethical standards, and independence standards (including any rules implementing Title II of the Act), and any other professional standards, that are established or adopted by the Board under Section 103 of the Act.

SECTION 7. PROFESSIONAL STANDARDS

Part 1—General Requirements

Rule 3100. Compliance With Auditing and Related Professional Practice Standards.

A registered public accounting firm and its associated persons shall comply with all applicable auditing and related professional practice standards.

Part 7—Establishment of Professional Standards

Rule 3700. Advisory Groups.

a. Formation.

To assist it in carrying out its responsibility to establish auditing and related professional practice standards, the Board will convene one or more advisory groups, in accordance with Section 103(a)(4) of the Act.

b. Composition.

Advisory groups, in combination or as sub-groups designated by the Board within one advisory group, will contain individuals with expertise in one or more of the following areas—

1. accounting;
2. auditing;
3. corporate finance;
4. corporate governance;
5. investing in public companies; and

6. other areas that the Board deems to be relevant to one or more auditing or related professional practice standards.

c. Selection of Members of Advisory Groups.

Members of advisory groups will be selected by the Board, in its sole discretion, based upon nominations, including self-nominations, received from any person or organization.

Note: The Board will announce, from time to time, periods during which it will receive nominations to an advisory group. During those periods, nominations may be submitted by any person or organization, including, but not limited to, any investor, any accounting firm, any issuer, and any institution of higher learning.

d. Personal Membership.

Membership in an advisory group will be personal to the individuals selected to serve on the advisory group. A member's functions and responsibilities, including attendance at meetings, may not be delegated to others.

e. Ethical Duties of Advisory Group Members.

Members of an advisory group shall comply with EC3, EC8(a), EC9, and, with respect to any private publication or public statement about the Board or any advisory group or any of the activities of the Board or any advisory group, EC10 of the Board's Ethics Code.

f. Ad Hoc Task Forces.

The Board may, in its discretion, establish ad hoc task forces. The membership of such task forces may include, but is not limited to, advisory group members. To the extent not otherwise required, members of ad hoc task forces shall comply with paragraph (e) of this Rule.

Appendix 2

Section-by-Section Analysis of Rules Relating to Auditing and Related Professional Practice Standards and Advisory Groups

Rules Relating to Auditing and Related Professional Practice Standards

The Rules relating to auditing and related professional practice standards consist of Rule 3100, plus a new definition that appears in Rule 1001. Each of the Rules, and the new definition, is discussed below.

Rule 1001—Definitions of Terms Employed in Rules.

Rule 1001 contains definitions of terms used in the Board's Rules.

Auditing and related professional practice standards

Rule 1001(a)(viii) defines “auditing and related professional practice standards” as the auditing standards, related attestation standards, quality control standards, ethical standards, and independence standards (including any rules implementing Title II of the Act), and any other professional standards, that are established or adopted by the Board under Section 103 of the Act.

The Board had proposed to use “professional auditing standards” as the term defined in this provision. Several commenters expressed concern that characterizing attestation, quality control, ethical, and independence standards as “professional auditing standards” would confuse people as to the defined term's meaning. To address these concerns, the Board has chosen to use the term “auditing and related professional practice standards” as the defined term for the standards established or adopted by the Board under Section 103 of the Act. The Board has used the longer term “auditing and related professional practice standards,” rather than the shorter “professional standards,” because the term “professional standards” is defined otherwise in Section 2(a)(10) of the Act. The term “auditing and related professional practice standards” is similar to that portion of the definition of the term “professional standards” that appears in Section 2(a)(10)(B) of the Act. (Hereinafter in this Section-by-Section Analysis, auditing and related professional practice standards shall be referred to as “Standards.”)

In addition, the Board's proposed definition was based on a portion of the definition of “professional standards” in Section 2(a)(10)(B) of the Act. For purposes of clarity, the Board has modified this definition slightly to track more closely the description of the standards the Board will set in Section 103(a)(1) of the Act. The definition still includes any other type of standard provided for in the definition of “professional standards” in Section 2(a)(10)(B) of the Act that the Board establishes or adopts under Section 103 of the Act. Accordingly, the definition, as revised, covers the same scope of standards as the Board's proposed rule.

**Rule 3100—Auditing and Related Professional Practice Standards
Applicable to Registered Public Accounting Firms.**

Rule 3100 provides that a registered public accounting firm and its associated persons must comply with all applicable Standards.¹ This Rule is intended to codify the obligation of registered public accounting firms and their associated persons to comply with applicable Standards and to ensure that the Board's Standards are enforceable.

A number of commenters suggested that this Rule was either beyond the Board's authority or would create the impression that the Rule applied to areas outside the Board's authority. To address these concerns, commenters suggested adding language about the scope of the Board's authority to Rule 3100. After considering these comments, the Board has decided to adopt the Rule as proposed.

The Board recognizes its responsibility to oversee the audits of issuers, as that term is defined in the Act, and does not intend to suggest that registered public accounting firms and their associated persons must comply with the Board's Standards in auditing non-issuers. Rule 3100, however, requires registered public accounting firms and their associated persons to comply with all *applicable* Standards. Accordingly, if the Board's Standards do not apply to an engagement or other activity of the firm, Rule 3100, by its own terms, does not apply to that engagement or activity.²

Finally, one commenter suggested that Rule 3100 also require registered public accounting firms and their associated person to be duly licensed, registered or permitted or otherwise to hold valid practice privileges and be in good standing under the laws of each applicable state. Registration with the Board does not supersede state registration or licensing requirements and the Board expects registered public accounting firms and their associated persons to comply with state and other applicable legal requirements. Rule 3100, however, is merely intended to codify the obligation of registered public accounting firms and their associated persons to comply with Board Standards and to ensure that the Board's Standards are enforceable. Accordingly, the Board has decided not to amend the Rule as proposed to reflect this suggestion.

¹ The Board's proposed rule included a note to clarify that proposed Rule 3100 was intended to apply to those public accounting firms that will be required to register with the Board immediately after the applicable date in order to continue to participate in the audits of issuers after such date. For U.S. public accounting firms the applicable date is October 22, 2003. Because of the approaching registration deadline, and because the Board's Interim Auditing Standards, as approved by the SEC, currently require these public accounting firms to comply with them, the Board has deleted the note as unnecessary.

² For example, the Board's Interim Auditing Standards provide that, "[i]n connection with the preparation or issuance of any audit report, a registered public accounting firm, and its associated persons, shall comply with generally accepted auditing standards, as described in the AICPA Auditing Standards Board's Statement of Auditing Standards No. 95, as in existence on April 16, 2003 (Codification of Statements on Auditing Standards, AU § 150 (AICPA 2002))." See Rule 3200T. The term "audit report" is defined in the Act and the Board's Rules to mean the audit of an issuer. See Rule 1001(a)(vi), adopted by the Board in PCAOB Release. No. 2003-007. Moreover, the Board notes that it would not be a correct description of its authority to say, as one commenter suggested Rule 3100 provide, that "A registered public accounting firm and its associated persons shall comply with all applicable professional auditing standards *in performing an audit of an issuer*." Particularly with respect to the quality control standards the Board is authorized to establish, the Board may adopt standards that, while related to registered public accounting firms' audit practices, must be complied with other than in the course of performing an audit. Cf. Section 103(a)(2)(B) of the Act (requiring the Board to include, among the "quality control standards that it adopts with respect to the issuance of audit reports, requirements . . . relating to . . . hiring, professional development, and advancement of personnel").

Rules Relating to Advisory Groups

Rule 3700—Advisory Groups.

Rule 3700 addresses certain basic matters concerning the formation and use of advisory groups in the Board's standards-setting process.³ The Rule provides that the Board will convene one or more advisory groups, as contemplated in Section 103(a)(4) of the Act. Any advisory group will consist of individuals with expertise in certain, specified areas relevant to the Board's standards-setting responsibilities. Members of an advisory group will be selected by the Board. In addition, the Rule provides for the Board to establish ad hoc task forces.⁴ While such task forces may include advisory group members, a task force may consist totally or partially of non-advisory group members who are persons with specialized experience in the standard-setting project under study. To the extent persons who serve on such task forces are not advisory group members or professional staff of the Board, they must comply with the ethics provisions applicable to advisory group members under Rule 3700(e).

The Rule further provides that membership on an advisory group will be personal to the individuals selected and that the functions of an advisory group member, including attendance at meetings, may not be delegated to others. This provision is based on a comparable provision in the Financial Accounting Standards Board's Rules governing the members of the Financial Accounting Standards Advisory Council.

Finally, Rule 3700 provides that members of a Board advisory group must comply with certain provisions in the Board's Ethics Code. Specifically, the Rule makes advisory group members subject to EC3, EC8(a) and EC9, and, to the extent applicable, EC10. These provisions of the Board's Ethics Code address, respectively, general ethical principles applicable to service for the Board, disqualification in the case of conflicts of interest, the non-disclosure of non-public information, and speaking for the Board when not authorized to do so by the Board.⁵

Commenters suggested that it might be appropriate to establish more than one advisory group since expertise is likely to be required in more than one specialized area. The Board is aware that it may need advice in one or more specialized area. However, the Board has determined to form only one standing advisory group (the "SAG"). This group, however, may, at the Board's direction, form specialized subgroups as needed. In addition, the Board may form ad hoc task forces to work with Board staff in formulating Standards in specialized areas which may then, in the Board's discretion, be added to the SAG's agenda for discussion at SAG meetings.

In addition, Commenters recommended adding other specific groups from which nominations could be received to the groups identified in Rule 3700(c) as proposed. After careful consideration of these comments, the Board has determined that Rule 3700(c) should reflect the Board's intention to accept nominations from all sources. Accordingly, Rule 3700(c) has been revised to state

³ The Rule does not address the use of an advisory group for matters other than standards-setting.

⁴ Such task forces may be formed without regard to the procedures for the formation, composition, and selection of advisory group members under Rule 3700(a)–(c).

⁵ See PCAOB Release No. 2003-008 (June 30, 2003) for the text of the Ethics Code adopted by the Board.

that the Board will accept nominations from any person or organization, including self-nominations. A note to this part of Rule 3700 provides that the Board will announce, from time to time, periods during which it will receive nominations for an advisory group.

With respect to qualifications of the advisory group members, one commenter suggested that all members have qualifications similar to those “requirements set forth for audit committee members in recently issued stock exchange and SEC” rules or proposed rules. The New York Stock Exchange (“NYSE”) proposed listing requirements require that all members of audit committees of listed companies be financially literate. In addition, at least one member of the audit committee must meet the definition of an “audit committee financial expert.”⁶ The NASDAQ Stock Market (“NASDAQ”) proposed rules regarding qualifications for service on audit committees require that all audit committee members must be able to read and understand financial statements including a company’s balance sheet, income statement, and cash flow statement and that the audit committee have at least one member who meets the definition of an “audit committee financial expert.”⁷ After considering this comment, the Board has decided to adopt the Rule as proposed by the Board. While Rule 3700 does not specifically state the qualifications each member must have, the Rule does set forth the types of expertise that the Board will look for in advisory group members. In addition, as noted in Section C.4. of this Release, the Board may also consider certain specific qualifications in selecting nominees to the SAG. The Board believes that it will likely select members who, at a minimum, would meet the general qualifications set forth for “all” audit committee members in the proposed Rules of the NYSE and NASDAQ while providing the Board with the flexibility to select members from a broad spectrum of backgrounds to assist it in meeting the requirements of the Act. SAG members will be selected based upon qualifications which will be elicited from them on a nomination form and through the evaluative process.

Furthermore, commenters suggested that the composition of the SAG be flexible because the Board may find that it is unable to attract a sufficient number of qualified members from fields such as finance and investment. In response to this concern, it should be noted that, the Board expects that the SAG will be broadly representative and that no one field of expertise will predominate among the SAG membership. Other concerns regarding composition related to assuring that the SAG have a sufficient number of members with technical expertise including requiring a majority of members to be practicing auditors. Although the Board certainly intends that the SAG have practicing auditors among its members, the Board believes that it is important that the SAG be able to provide advice in a broad range of areas, including technical auditing expertise, and that technical expertise in particular areas may be obtained by forming ad hoc task forces, as needed and as appropriate for particular standards-setting projects. Other commenters recommended that—

- a.* the four largest auditing firms be represented on the SAG;
- b.* non-U.S. auditors be represented;
- c.* the number of members associated with a single firm, company or association be limited;
- d.* membership be dispersed among those affiliated with firms, companies and associations of various sizes;

⁶ See SEC Release No. 34-47672; File No. SR-NYSE-2002-33 (April 11, 2003).

⁷ See SEC Release No. 34-47516; File No. SR-NASD-2002-141 (March 17, 2003).

- e. there be a balance between financial information suppliers (representatives of public companies and auditors) and financial information users (equity and debt investors).

As noted above, the Board recognizes the need to have diversity on the SAG and in selecting members will keep diversity in mind while assuring that no one expertise will predominate among the SAG membership.

With respect to the actual functions of the SAG, one commenter, suggested that the SAG be involved in all standards-setting proposals while another commenter recommended that the actual drafting of the Standards fall within the SAG's authority. In order to maintain flexibility in the rulemaking process, the Board has determined not to revise the proposed Rule to reflect these comments. Although the SAG is likely to be involved in the Board's standards-setting process as discussed in the Release, the Board does not intend to make SAG involvement mandatory to every standards-setting project. In addition, the actual drafting of the Standards is likely to be done by the Board's staff assisted by ad hoc task forces where necessary.

Another comment related to recommending that the SAG work toward "harmonizing" international standards. Neither Rule 3100 nor 3700 is intended to address substantive standards-setting issues. Rather the Board intends to address such issues, including cooperation with standards-setters in other jurisdictions, in the future.

Commenters also made recommendations regarding SAG procedural matters. These commenters suggested that the Board address—

- a. the process for making recommendations on Standards for consideration by the Board;
- b. whether or not SAG meetings would be open to the public;
- c. the format and the frequency of the meetings;
- d. the process by which the Board will set the SAG's agenda;
- e. the appointment of a Chair for the SAG;
- f. whether the Board will provide all resources for drafting, editing, monitoring comments and publishing new and amended Standards;
- g. the term of appointment to the SAG; and
- h. an avenue for minority viewpoints to be expressed in any report or recommendation to the Board.

With the exception of the comment on resources for drafting and publishing new Standards, the Board has addressed all of these comments in Section B.7. of the Release. In summary, the SAG will hold an annual meeting and a semi-annual meeting. Additional meetings may be held in the intervening quarters. Monthly telephonic meetings are also expected to be held at the discretion of the Chair. The annual and semi-annual meetings, and any meeting at which the SAG makes a final decision on a recommendation to the Board, will be open to the public. Agenda items for the SAG will be driven in part by the schedule to be set by the Board for the review of the Interim Auditing Standards. Other agenda items will be added by the Board where the Board determines that a response to emerging issues or problems connected with audits needs to be addressed. The Board has determined that the first Chair of the SAG will be the Board's Chief Auditor and Director of Professional Standards. All SAG members will be appointed for two-year terms except that approximately one-half of the appointees initially appointed to the SAG will be

appointed for a three-year term to assure continuity. There will be no limits on the terms that a member of the SAG may serve. The Board anticipates that drafting, editing, monitoring comments and publishing, will be conducted by the Board and its staff. To the extent that the SAG is specifically authorized by the Board to undertake any of these functions and the expenses have been preapproved by the Board or a staff member delegated by the Board, the Board will cover the SAG's costs.

In response to the issue of whether the SAG's meetings will be open to the public and in order to assure that the public is informed of the SAG's operations, the Board has determined that the annual and semi-annual meetings of the SAG will be open. In addition, decisions on making recommendations to the Board will only be made at an open meeting of the SAG. All recommendations to the Board by the SAG will be presented to the Board in open public meetings of the Board and such presentations will include the presentation of minority views of the SAG members. Finally, it should be noted that Board standards-setting proposals will be subject to the public comment process before being adopted by the Board.

With respect to Rule 3700(e) relating to the ethical duties of the SAG members, one commenter recommended that the SAG members be subject to Section EC14, the certification requirements, of the Ethics Code. In response to this comment, the Board has added to its "conditions of membership" described in Section C of the Release, a requirement that members of the SAG shall annually certify their continuing compliance with the "conditions of membership." A second commenter recommended that both Rule 3700(e) and EC8(a) of the Ethics Code be clarified to confirm that being a practicing auditor does not, in and of itself, constitute a financial interest requiring recusal. Section EC8(a) of the Ethics Code has been revised to add an explanatory note that clarifies this issue.⁸ A third commenter recommended that members of the SAG be prohibited from "unauthorized" speaking for the Board. In response to this comment, the Board has revised Rule 3700(e) to make EC10 of the Board's Ethics Code applicable to any private publication or public statement by an advisory group member with regard to the Board or the advisory group or any of the activities of the Board or the advisory group. Finally, a fourth commenter recommended that a member of the SAG be permitted to share SAG material with support personnel within the member's home organization who are assigned to assist the member in his or her duties. The Board has not added a provision to address this concern. The Board believes that SAG members will normally be able to perform their responsibilities without needing access to non-public Board information. To the extent that it may be appropriate, from time to time, to permit non-public standards-setting information to be shared with individuals outside the SAG, including to permit SAG members to consult technical experts who are not employees or staff of the Board, the Board may require that such individuals agree to the confidentiality provisions under Section EC9 of the Ethics Code.

[The next page is 2461.]

⁸ See PCAOB Release No. 2003-008 (June 30, 2003).

PC Section 130

References in Auditors' Reports to the Standards of the Public Company Accounting Oversight Board

PCAOB Release No. 2003-025
December 17, 2003

PCAOB Rulemaking
Docket Matter No. 010

Summary:

After public comment, the Public Company Accounting Oversight Board (the "Board" or "PCAOB") has adopted Auditing Standard No. 1, *References in Auditors' Reports to the Standards of the Public Company Accounting Oversight Board*. This standard requires registered public accounting firms to include in their reports on engagements performed pursuant to the Board's auditing and related professional practice standards, including audits and reviews of financial statements, a reference to the standards of the Public Company Accounting Oversight Board (United States). The Board will submit this standard to the Securities and Exchange Commission ("Commission" or "SEC") for approval pursuant to Section 107 of the Sarbanes-Oxley Act of 2002 (the "Act"). This standard will not take effect unless approved by the Commission.

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Section 103 of the Act authorizes the PCAOB to establish auditing and related professional practice standards to be used by registered public accounting firms in connection with the preparation and issuance of audit reports as required by the Act or the rules of the Commission, or as may be necessary or appropriate in the public interest or for the protection of investors. Consistent with Section 103 of the Act, PCAOB Rule 3100, *Compliance With Auditing and Related Professional Practice Standards* [section 120], requires auditors to comply with all applicable auditing and related professional practice standards established by the PCAOB.

Auditing Standard No. 1, *References in Auditors' Reports to the Standards of the Public Company Accounting Oversight Board* directs auditors¹ to state that

¹ Reference in the Board's standards to an "auditor" means a registered public accounting firm, or an associated person of such a firm, as defined in the Act and the Board's rules, unless specifically stated otherwise. Nothing in the Board's rules would preclude an accounting firm from conducting an audit of a company that is not an issuer in accordance with the Board's standards and so stating in its audit report. This is true regardless of whether or not the accounting firm performing the audit is registered with the Board.

the engagement was conducted in accordance with “the standards of the Public Company Accounting Oversight Board (United States)” whenever the auditor has performed the engagement in accordance with the Board’s standards.

Section A of this release describes Auditing Standard No. 1. Section B of this release discusses and addresses the comments received on the Board’s proposed auditing standard, which the Board released for public comment. The text of Auditing Standard No. 1 is attached to this release as Appendix 1.

A. Description of Auditing Standard No. 1

At the time of this release, the Board’s auditing and related professional practice standards consist of the standards described in Rules 3200T through 3600T [section 110], which the Board has adopted, on an initial, transitional basis, as interim standards. The standards (with which PCAOB Rule 3100 [section 120] requires registered public accounting firms, and persons associated with such firms, to comply) include these interim standards and any permanent standards that the Board adopts.

Each of the standards described in Rules 3200T through 3600T [section 110] was originally adopted by the American Institute of Certified Public Accountants (“AICPA”), a committee thereof, including the Auditing Standards Board (“ASB”), or the Independence Standards Board. Thus the Board’s rule on interim auditing standards, Rule 3200T [section 110], incorporates “generally accepted auditing standards, as described in the AICPA Auditing Standards Board’s Statement on Auditing Standards No. 95, *Generally Accepted Auditing Standards*, in existence on April 16, 2003” (the “interim standards”).² These auditing standards were adopted, and from time to time amended, by the ASB, until the Board incorporated them into the Board’s interim standards. The interim standards require auditors to include in their reports a reference to the standards that were followed in performing the engagement. These references include “generally accepted auditing standards,” “U.S. generally accepted auditing standards,” “auditing standards generally accepted in the United States of America,” and “standards established by the AICPA.”

PCAOB Auditing Standard No. 1 supersedes these references by requiring that auditors’ reports on the financial statements of issuers that are issued or reissued, after Auditing Standard No. 1 becomes effective, include a statement that the engagement was conducted in accordance with “the standards of the Public Company Accounting Oversight Board (United States).”³ This auditing standard is effective for auditors’ reports issued or reissued on or after the 10th day following approval of this auditing standard by the Commission. An appendix⁴ to this standard provides illustrative reports on an audit of financial statements and a review⁵ of interim financial information of a public company.

Once Auditing Standard No. 1 becomes effective, it will require auditors to state that the engagement was performed in accordance with “the standards of the Public Company Accounting Oversight Board (United States),” irrespective of whether the engagement was conducted before or after Auditing

² The Board’s rules on interim standards were adopted by the Board on April 16, 2003, and approved by the Commission on April 25, 2003. See SEC Rel. No. 33-8222 (April 25, 2003).

³ See Auditing Standard No. 1 ¶ 3.

⁴ Appendices to the Board’s standards are an integral part of the standard and carry the same authoritative weight as the body of the standard.

⁵ Reviews of the interim financial information are integrally related to audits of financial statements. See generally Statement on Auditing Standards No. 100, *Interim Financial Information* (“SAS No. 100”). For example, SAS No. 100 makes clear that the general standards on auditing discussed in SAS No. 95 “are applicable to a review of interim financial information.”

Standard No. 1 becomes effective. Accordingly, auditors who reissue reports that were originally issued before the date that Auditing Standard No. 1 becomes effective, or who issue reports that include comparative financial information that was the subject of an audit or review report that was issued before that date, must nevertheless state that the audit or review was performed in accordance with “the standards of the Public Company Accounting Oversight Board (United States),” if those reports are reissued after Auditing Standard No. 1 becomes effective. The Board believes that a uniform reference to the standards of the PCAOB—even with respect to audits and reviews completed before the PCAOB adopted its interim standards—is appropriate because the interim standards that the Board adopted are the “generally accepted auditing standards” with which auditors were required to comply before the PCAOB adopted its interim standards.

Referring to PCAOB standards in connection with a period that preceded the date of the PCAOB's own adoption of those standards may seem somewhat counterintuitive. The requirement is intended, however, to reflect the fact that the standards in place before the PCAOB adopted its interim standards, without change, became the PCAOB's standards. Indeed, the Board considered whether to require auditors to refer to “generally accepted auditing standards” when reissuing reports that were originally issued before Auditing Standard No. 1 becomes effective, and to refer to “standards of the PCAOB” with respect to reports issued on or after Auditing Standard No. 1 becomes effective.

The Board believes, however, that it is appropriate to describe the “generally accepted auditing standards” that the Board adopted as “standards of the PCAOB.” This terminology will reflect the fact that the standards that auditors were required to use before April 25, 2003—i.e., generally accepted auditing standards as they existed on April 16, 2003—became the applicable standards on April 25 and continue to apply to audits of public companies, as the Board amends them. Auditing standards have continuously been amended over time, and auditors have consistently been required to state whether their audits complied with the then-prevailing standards. The substance of the applicable standards for audits and reviews of public company financial statements did not change on April 25, 2003. Rather, April 25, 2003, is significant only because the PCAOB gained authority over such standards on that date. The Board believes it would be inappropriate to create an impression in auditors' reports that engagements performed before Auditing Standard No. 1 becomes effective, or even before April 25, were performed in accordance with a wholly different body of standards, rather than the same body of standards at different points in its evolution.

The Board expects to amend its standards from time to time, just as the ASB amended generally accepted auditing standards from time to time. The Board believes that using a consistent description of standards prevailing at the time an audit or review report is issued—and holding auditors to compliance with those then-prevailing standards—better contributes to the creation of informative audit reports.

Upon adoption of this auditing standard, all references in the interim standards to generally accepted auditing standards, U.S. generally accepted auditing standards, auditing standards generally accepted in the United States of America, and standards established by the AICPA, mean the corresponding standards of the Public Company Accounting Oversight Board. The Act and the Board's rules already require the auditor to comply with the Board's standards. The purpose of this standard is to conform the references in the interim standards to the

standards that the Act and Rule 3100 [section 120] require auditors to use in connection with preparing and issuing audit and related reports on the financial statements of issuers.

Under the Act, Auditing Standard No. 1 will not be effective unless it is approved by the SEC. By its terms, Auditing Standard No. 1 will be effective for auditors' reports issued or reissued on or after the 10th day following SEC approval of this standard. Until the effective date of this standard, the reporting requirements as described in the AICPA's Codification of Statements on Auditing Standards, are still in effect as interim standards.

B. Public Comment Process and Board Responses

The Board released a proposed auditing standard, *References in Auditors' Reports to the Standards of the Public Company Accounting Oversight Board*, for public comment, on November 12, 2003. The Board received eight written comment letters.⁶ In response to these comments, the Board's final rules both clarify and modify certain aspects of the proposal, as explained below.

1. Transitional Issues

The Board received several comments related to transitional issues, including, how the proposed standard would affect—

- reissuance of a report originally issued before the proposed standard became effective;
- issuance of a report on comparative financial statements when the audits of the financial statements for periods presented for comparative purposes were conducted before the proposed standard became effective and/or before the Board adopted its interim standards; and
- issuance of a dual-dated report that include dates that straddle the effective date of this standard.

In the proposed standard, the Board had recommended the standard be effective for auditors' reports dated on or after the later of January 1, 2004 or the 10th day after SEC approval of the standard as adopted by the Board. In evaluating the comments with regard to transition, the Board decided to modify the effective date of this standard. Rather than linking the effective date of this standard to the date of the report, this auditing standard will be effective for reports issued or reissued on or after the 10th day following SEC approval of this auditing standard. After this standard becomes effective, any auditor's report issued or reissued with respect to the financial statements of a public company must state that the engagement was performed in accordance with "the standards of the Public Company Accounting Oversight Board (United States)."

One commenter also expressed concern that the proposed standard's requirement that a report state that an audit performed prior to the PCAOB's adoption of interim standards was performed in accordance with PCAOB standards would, in essence, require the auditor to re-audit the prior period's financial statements in order to bring that audit or review into conformity with current PCAOB standards. The Board does not intend to require auditors to bring audits that were performed in accordance with then-prevailing standards

⁶ The comment letters are available on the Board's Web site—www.pcaobus.org—and will be attached to the Board's Form 19b-4, to be filed with the Commission.

into conformity with later-prevailing standards in order to reissue a previously-issued report. When the Board adopted as interim standards the generally accepted auditing standards established by the ASB, the Board also adopted the effective dates of those standards. Therefore, reference in auditors' reports to the standards of the PCAOB with respect to financial statements audited or reviewed prior to the effective date of Auditing Standard No. 1 is equivalent to the previously-required reference to generally accepted auditing standards. The reference relates to those standards that were in effect when the audit or review was completed and should not be interpreted to imply a representation that the audit or review complied with standards that became effective after the audit or review was completed. Thus, once Auditing Standard No. 1 becomes effective, a reference to generally accepted auditing standards in reports issued in connection with financial statements of public companies is no longer appropriate or necessary.

2. Applicable Standards of the PCAOB

Several commenters recommended that the Board only require auditors' reports to refer to the *auditing* standards of the PCAOB for audits of financial statements and not to the standards of the PCAOB generally. The Board intends for report references to "the standards of the Public Company Accounting Oversight Board (United States)" to mean those auditing and related professional practice standards that are applicable to the particular engagement. For example, if an issuer does not use any outside service organization that would affect its internal control over financial reporting, then the interim auditing standard on service organizations—described in the Codification of Statements on Auditing Standards at AU § 324 (*Service Organizations*), would not be applicable. On the other hand, the Board's independence standards apply to registered public accounting firms, and associated persons thereof, in connection with the preparation and issuance of audit reports for issuers.

As another example, quality control standards generally apply to a firm's system of quality control over its accounting and auditing practice and not to individual audit engagements. Thus, a breakdown in the system of quality control does not necessarily mean that a particular audit was not conducted in accordance with the standards of the PCAOB. However, such a breakdown might result in a deficient audit if it caused or contributed to an audit deficiency. The determination as to whether a particular auditing or related professional practice standard is applicable in the context of a particular audit is dependent on the nature of the standard in question and on the nature of the engagement at issue.

Thus a reference to "auditing standards" of the PCAOB would be too narrow and preclusive to other standards applicable to the audit. The Board believes that reference to "the standards of the Public Company Accounting Oversight Board (United States)" is a more descriptive reference to the standards applied in the audit.

3. Reference to GAAS

The Board received a number of comments recommending that auditors' reports, with respect to financial statement audits, describe PCAOB standards as generally accepted auditing standards. The notion of general acceptance developed at a time when auditing and accounting standards were not established with the force of law by governmental or other authoritative bodies, but rather were established by consensus among the members of the accounting profession.

As far as auditing and related professional practice standards are concerned, the Board gained authority to establish such standards by the enactment of the Act. Professional consensus is no longer sufficient to establish auditing standards, and therefore the Board believes that it is no longer appropriate to refer to the standards with which an auditor of the financial statements of a public company must comply as “generally accepted.” While those standards may be generally accepted in a variety of contexts, what gives them the force of law in the context of public company audits is adoption by the PCAOB and approval by the SEC.

Therefore, for purposes of any engagement performed in accordance with the applicable auditing and related professional practice standards of the PCAOB, references in the interim standards to generally accepted auditing standards, U.S. generally accepted auditing standards, auditing standards generally accepted in the United States of America, and standards established by the AICPA, mean the standards of the PCAOB.

4. References to Country of Origin and Issuing Office

The Board also received comments recommending that the Board continue to require auditors to state in their reports that the standards according to which they performed their engagements were those standards applicable in the United States. Adopting this recommendation will make it easier for readers of audit reports that are used in cross-border offerings and listings of securities to quickly identify the jurisdiction in which the standards were promulgated. As such, the Board has required in Auditing Standard No. 1 that auditors’ reports describe the PCAOB’s standards as “the standards of the Public Company Accounting Oversight Board (United States).”

Another commenter recommended that auditors identify in their reports the city and state (or country) of the registered firms issuing the reports. The SEC’s rules require disclosure in the auditor’s report of the city and state of the accounting firm’s office issuing the report.⁷ The Board also concurs with this recommendation and, accordingly, has modified the auditing standard and the illustrative reports in the appendix to Auditing Standard No. 1.

5. Other Auditors

The Board was asked to clarify the applicability of this standard, and the Board’s standards generally, to circumstances where more than one auditing firm contributes to an audit of a consolidated entity. For example, a firm other than the firm engaged to report on the company’s consolidated financial statements may be hired to audit the financial statements of a subsidiary company. In such circumstances, the auditor that conducts the majority of the audit is referred to as the principal auditor and the auditor of the subsidiary company is referred to as the other auditor.⁸ Depending on the significance of the portion of the financial statements audited by the other auditor, the principal auditor may divide responsibility with the other auditor by making reference to the audit of the other auditor in his or her report, or the principal auditor may take responsibility for the work of the other auditor by not making any reference to the other auditor.

In either event, the entire audit must be performed in accordance with the Board’s standards. Section 103 of the Act, and the Board’s Rule 3100 [section

⁷ 17 C.F.R. § 210.2-02 (2003).

⁸ See Codification of Auditing Standards, AU § 543 (AICPA 2002).

120], require registered public accounting firms, and associated persons thereof, to comply with all applicable auditing and related professional practice standards in connection with the preparation and issuance of audit reports on the financial statements of issuers. Whether the other auditor is a registered public accounting firm or an associated person of a registered public accounting firm, the other auditor must comply with the standards of the PCAOB.

6. Applicability to Non-U.S. Firms Not Yet Registered With the Board

Another commenter asked the Board to clarify whether non-U.S. public accounting firms—who are not required to register with the PCAOB until 2004—will be permitted, until registered with the PCAOB, to continue to reference “auditing standards generally accepted in the United States of America” when reporting on an issuer’s financial statements. Like the Board’s interim standards, with which a public accounting firm is required to comply even before the firm’s mandatory registration date, during the period preceding the mandatory registration date, standards of the PCAOB apply to firms engaged in work that requires their registration. Therefore, non-U.S. public accounting firms that have not yet registered, that engage in work that would require them to be registered as of the mandatory registration date, are nevertheless required to reference “the standards of the Public Company Accounting Oversight Board (United States).”

7. Application of Auditing Standard No. 1 to Audit Reports in Connection With Initial Public Offerings

Another commenter recommended that the Board expand the proposed standard to specifically address the various scenarios that auditors will encounter with respect to reporting in conjunction with initial public offerings. The SEC’s Rule 3-01 of Regulation S-X requires that, like other SEC filings that must comply with Regulation S-X, a registration statement filed in connection with an initial public offering must include or otherwise incorporate “for the registrant and its subsidiaries consolidated, audited balance sheets as of the end of each of the two most recent fiscal years.”⁹ In addition, Rule 3-02 of Regulation S-X requires that there “be filed, for the registrant and its subsidiaries consolidated and for its predecessors, audited statements of income and cash flows for each of the three fiscal years preceding the date of the most recent audited balance sheet.”¹⁰ The Board understands these provisions to mean that an issuer desiring to register a transaction involving the sale of securities must include balance sheets for the two years preceding the transaction, and income statements and statements of cash flows for the three years preceding the transaction, each audited in accordance with standards as required by the securities laws.

In Section 103 of the Act, Congress has provided the Board authority to establish auditing and related professional practice standards “to be used by registered public accounting firms in the preparation and issuance of audit reports.” In addition, the PCAOB has adopted, and the SEC has approved, PCAOB Rule 3100 [section 120], which requires registered public accounting firms to comply with all applicable auditing and related professional practice standards of the PCAOB in connection with the preparation and issuance of

⁹ 17 C.F.R. § 210.3-01 (2003).

¹⁰ 17 C.F.R. § 210.3-02 (2003).

audit reports on the financial statements of issuers. Accordingly, audit reports on the financial statements of issuers must now comply with—and under Auditing Standard No. 1 auditors must state that they performed the audit in accordance with—the standards of the PCAOB. So long as audits that were performed prior to April 25, 2003, were performed in accordance with then-prevailing generally accepted auditing standards as required by Rule 2-02 of Regulation S-X, an auditor need not reaudit any financial statements that relate to periods preceding April 25, 2003. Further, as discussed above, because the Board adopted the “generally accepted auditing standards” in effect as of April 16, 2003, the Board believes it is appropriate to require auditors who issue or reissue reports on periods prior to the date Auditing Standard No. 1 becomes effective to state that their audits were performed in accordance with PCAOB standards, so long as they were performed in accordance with the “generally accepted auditing standards” prevailing at the time the audits were performed.

* * * * *

On the 17th day of December, in the year 2003, the foregoing was, in accordance with the bylaws of the Public Company Accounting Oversight Board,

ADOPTED BY THE BOARD.

/s/ J. Gordon Seymour

J. Gordon Seymour

Acting Secretary

December 17, 2003

APPENDIX:

References in Auditors’ Reports to the Standards of the Public Company Accounting Oversight Board

Appendix

References in Auditors' Reports to the Standards of the Public Company Accounting Oversight Board

1. The Sarbanes-Oxley Act of 2002 authorized the Public Company Accounting Oversight Board ("PCAOB") to establish auditing and related professional practice standards to be used by registered public accounting firms. PCAOB Rule 3100, *Compliance With Auditing and Related Professional Practice Standards* [section 120], requires the auditor to comply with all applicable auditing and related professional practice standards of the PCAOB.

2. The Board has adopted as interim standards, on an initial, transitional basis, the generally accepted auditing standards, described in the American Institute of Certified Public Accountants' ("AICPA") Auditing Standards Board's Statement on Auditing Standards No. 95, *Generally Accepted Auditing Standards*, in existence on April 16, 2003.¹

3. Accordingly, in connection with any engagement performed in accordance with the auditing and related professional practice standards of the PCAOB, whenever the auditor is required by the interim standards to make reference in a report to generally accepted auditing standards, U.S. generally accepted auditing standards, auditing standards generally accepted in the United States of America, or standards established by the AICPA, the auditor must instead refer to "the standards of the Public Company Accounting Oversight Board (United States)." An auditor must also include the city and state (or city and country, in the case of non-U.S. auditors) from which the auditor's report has been issued.

4. This auditing standard is effective for auditors' reports issued or reissued on or after the 10th day following approval of this auditing standard by the Securities and Exchange Commission.

5. Audit reports issued prior to the effective date of this standard were required to state that the audits that supported those reports were performed in accordance with generally accepted auditing standards. The PCAOB adopted those generally accepted auditing standards, including their respective effective dates, as they existed on April 16, 2003, as interim standards. Therefore, reference to "the standards of the Public Company Accounting Oversight Board (United States)" with respect to audits of financial statements performed prior to the effective date of this standard is equivalent to the previously-required reference to generally accepted auditing standards. Accordingly, upon adoption of this standard, a reference to generally accepted auditing standards in auditors' reports is no longer appropriate or necessary.

Note: The term "auditor" in this standard is intended to include both registered public accounting firms and associated persons thereof.

¹ The Board's rules on interim standards were adopted by the Board on April 16, 2003, and approved by the Commission on April 25, 2003. See SEC Rel. No. 33-8222 (April 25, 2003).

APPENDIX—Illustrative Reports

1. The following is an illustrative report on an audit of financial statements:

Report of Independent Registered Public Accounting Firm

We have audited the accompanying balance sheets of X Company as of December 31, 20X3 and 20X2, and the related statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 20X3. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of [at] December 31, 20X3 and 20X2, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 20X3, in conformity with U.S. generally accepted accounting principles.

[Signature]

[City and State or Country]

[Date]

2. The following is an illustrative report on a review of interim financial information:

Report of Independent Registered Public Accounting Firm

We have reviewed the accompanying [*describe the interim financial information or statements reviewed*] of X Company as of September 30, 20X3 and 20X2, and for the three-month and nine-month periods then ended. This (these) interim financial information (statements) is (are) the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying interim financial (statements) for it (them) to be in conformity with U.S. generally accepted accounting principles.

[Signature]

[City and State or Country]

[Date]

[The next page is 2491.]