

SECURITIES AND EXCHANGE COMMISSION

17 CFR PARTS 211, 231, AND 241

[Release Nos. 33-8422; 34-49708; FR-73]

Commission Guidance Regarding the Public Company Accounting Oversight Board's Auditing and Related Professional Practice Standard No. 1

AGENCY: Securities and Exchange Commission.

ACTION: Interpretation.

SUMMARY: The Commission is publishing interpretive guidance regarding Auditing and Related Professional Practice Standard No. 1, References in Auditors' Reports to the Standards of the Public Company Accounting Oversight Board ("Auditing Standard No. 1") of the Public Company Accounting Oversight Board (the "PCAOB").

EFFECTIVE DATE: May 14, 2004.

FOR FURTHER INFORMATION CONTACT: Questions about specific filings should be directed to staff members responsible for reviewing the documents the registrant files with the Commission. General questions about this release should be referred to Consuelo Hitchcock, Division of Corporation Finance, at (202) 942-2960 or to Esmeralda Rodriguez, Office of the Chief Accountant, at (202) 942-4400, Securities and Exchange Commission, 450 5th Street NW, Washington, DC 20549-0401.

SUPPLEMENTARY INFORMATION:

I. Background

Section 103(a) of the Sarbanes-Oxley Act of 2002 (the "Act") authorized the PCAOB to establish auditing and related professional practice standards to be used by registered public accounting firms.¹ On December 23, 2003, the PCAOB filed with the

¹ Pub. L. 107-204, 116 Stat. 745 (2002).

Commission proposed Auditing Standard No. 1, References in Auditing Reports to the Standards of the Public Company Accounting Oversight Board.² After soliciting comments on the proposed standard,³ the Commission today approved Auditing Standard No. 1, effective for auditors' reports issued or reissued on or after May 24, 2004.⁴ Auditing Standard No. 1 directly impacts certain of the Commission's rules, regulations, releases and staff bulletins (collectively referred to in this release as "Commission rules and staff guidance") and certain provisions in the federal securities laws, which refer to Generally Accepted Auditing Standards ("GAAS") and to specific standards under GAAS (including related professional practice standards), because it directs auditors to cease referring to GAAS in audit reports relating to financial statements of issuers and instead to refer to the "standards of the Public Company Accounting Oversight Board (United States)."⁵ The Commission is therefore issuing interpretive guidance to avoid confusion on the part of issuers, auditors and investors. The guidance in this release is applicable only to auditors' engagements that are governed by PCAOB rules.⁶

² The PCAOB approved Auditing Standard No. 1 on December 17, 2003. PCAOB Release No. 2003 – 25 (December 17, 2003) (the "PCAOB Adopting Release").

³ Release No. 34-49528 (April 6, 2004).

⁴ Release No. 34-49707 (May 14, 2004).

⁵ PCAOB Adopting Release at A-2.

⁶ The PCAOB, for example, has not established particular auditing standards for non-issuer broker-dealers or investment advisers. This release is not applicable to such engagements and related filings.

II. Discussion

A. References to GAAS in Commission Rules and Staff Guidance and in the Federal Securities Laws

PCAOB Rule 3100 requires registered public accounting firms and their associated persons to comply with all applicable auditing and related professional practice standards established or adopted by the PCAOB. Because of this and because the PCAOB has adopted interim standards incorporating generally accepted auditing standards, references to GAAS and standards established by the American Institute of Certified Public Accountants (the "AICPA") are now superseded. Auditing Standard No. 1 requires that an auditor's report issued in connection with any engagement performed in accordance with the auditing and related professional practice standards of the PCAOB state that the engagement was performed in accordance with "the standards of the Public Company Accounting Oversight Board (United States)."⁷ In addition, Auditing Standard No. 1 states that "a reference to generally accepted auditing standards in auditors' reports is no longer appropriate or necessary."⁸

Many parts of Commission rules and staff guidance include direct references to GAAS. For example, Regulation S-X, which, together with the Commission's Financial Reporting Releases, sets forth the form and content of and requirements for financial statements required to be filed with the Commission,⁹ includes Rule 2-02 regarding the accountant's report.¹⁰ Rule 2-02 of Regulation S-X states in relevant part:

⁷ PCAOB Adopting Release at A-2.

⁸ Id. at 7.

⁹ 17 CFR 210.1-01.

¹⁰ 17 CFR 210.2-02.

“Representations as to the audit. The accountant's report: (1) Shall state whether the audit was made in accordance with generally accepted auditing standards. . . .”¹¹

Moreover, some Commission rules and staff guidance refer to specific auditing standards under GAAS. For example, Accounting Series Release No. 296, which is now in Section 601 of Financial Reporting Codification, references AU 220.03 of the Codification of Auditing Standards published by the AICPA.¹² Finally, some parts of Commission rules and staff guidance could be said to include indirect references to GAAS because in releases or staff bulletins the Commission or its staff has interpreted rules and regulations by directing registrants, auditors and investors to GAAS.

In addition, the federal securities laws refer to GAAS. Specifically Section 10A(a) of the Securities Exchange Act of 1934 states:

“[e]ach audit required pursuant to this title of the financial statements of an issuer by a registered public accounting firm shall include [the following procedures and an evaluation], in accordance with generally accepted auditing standards, as may be modified or supplemented from time to time by the Commission. . . .”¹³

Given the possible confusion between Commission rules and staff guidance and references in the federal securities laws, on the one hand, and the PCAOB's rules, on the other hand, the Commission believes it is necessary to publish the guidance in this release. Effective immediately, references in Commission rules and staff guidance and in the federal securities laws to GAAS or to specific standards under GAAS, as they relate to issuers, should be understood to mean the standards of the PCAOB plus any applicable

¹¹ Id.

¹² FRC 601. AU 220.03 is among the standards adopted by the PCAOB on an interim, transitional basis.

rules of the Commission. The Commission intends to codify this interpretation in the near future.

It should be noted that although the PCAOB has stated that Auditing Standard No. 1 supersedes references 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,”¹⁴ Auditing Standard No. 1 does not supersede Commission rules or regulations. Section 3(c) of the Act provides that “[n]othing in this Act or the rules of the Board shall be construed to impair or limit ... (2) 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....” When an independent accountant prepares a report for submission or filing with the Commission, the independent accountant would be considered to be representing that it has complied with the applicable federal securities laws and Commission rules and guidance, as well as with the standards of the Public Company Accounting Oversight Board (United States), as referenced explicitly in Auditing Standard No. 1. In a note to PCAOB Rule 3600T, Interim Independence Standards, the Board specifically provided that the PCAOB’s rules do not supersede the Commission’s rules, and, therefore, registered public accounting firms must comply with the more restrictive of the Commission’s or the Board’s rules.

¹³ 15 U.S.C. 78j-1.

¹⁴ PCAOB Adopting Release at 3.

B. Incorporation by Reference

Some registrants are able to incorporate by reference previously issued and filed reports by including an auditor's consent to the use of their report in the registrant's filing that requires the audit report. If a registrant incorporates by reference a report previously filed with the Commission, rather than including a new report in the filing, the report incorporated by reference would not need to include the otherwise-required reference to the standards of the PCAOB.

List of Subjects

17 CFR Part 211

Reporting and recordkeeping requirements, Securities.

17 CFR Parts 231 and 241

Securities.

Amendments to the Code of Federal Regulations

For the reasons set forth above, the Commission is amending title 17, chapter II of the Code of Federal Regulations as set forth below:

PART 211 — INTERPRETATIONS RELATING TO FINANCIAL REPORTING MATTERS

1. Part 211, Subpart A, is amended by adding Release No. FR-73 and the release date of May 14, 2004 to the list of interpretive releases.

PART 231 — INTERPRETATIVE RELEASES RELATING TO THE SECURITIES ACT OF 1933 AND GENERAL RULES AND REGULATIONS THEREUNDER

2. Part 231 is amended by adding Release No. 33-8422 and the release date of May 14, 2004 to the list of interpretive releases.

**PART 241 — INTERPRETATIVE RELEASES RELATING TO THE
SECURITIES EXCHANGE ACT OF 1934 AND GENERAL RULES AND
REGULATIONS THEREUNDER**

3. Part 241 is amended by adding Release No. 34-49708 and the release date of May 14, 2004 to the list of interpretive releases.

By the Commission.

J. Lynn Taylor
Assistant Secretary

Dated: May 14, 2004