

writing within 60 days of this publication.

Direct your written comments to R. Corey Booth, Director/Chief Information Officer, Office of Information Technology, Securities and Exchange Commission, 450 5th Street, NW., Washington, DC 20549.

Dated: July 26, 2004.

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-50077; File No. PCAOB-2004-06]

Public Company Accounting Oversight Board; Notice of Filing of Proposed Rule 3101, Certain Terms Used in Auditing and Related Professional Practice Standards

July 26, 2004.

Pursuant to section 107(b) of the Sarbanes-Oxley Act of 2002 (the "Act"), notice is hereby given that on June 18, 2004, the Public Company Accounting Oversight Board (the "Board" or the "PCAOB") filed with the Securities and Exchange Commission (the "Commission" or "SEC") the proposed rule described in items I and II below, which items have been prepared by the Board and are presented here in the form submitted by the Board. The Commission is publishing this notice to solicit comments on the proposed rule from interested persons.

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

On June 9, 2004, the Board adopted Rule 3101, *Certain Terms Used in Auditing and Related Professional Practice Standards* ("the proposed rule"). The proposed rule text is set out as follows:

RULES OF THE BOARD

SECTION 1. GENERAL PROVISIONS

Rule 1001. Definitions of Terms Employed in Rules.

(a)(xii) Auditor

The term "auditor" means both public accounting firms registered with the Public Company Accounting Oversight Board and associated persons thereof.

SECTION 3. PROFESSIONAL STANDARDS

Part 1—General Requirements

Rule 3101. Certain Terms Used in Auditing and Related Professional Practice Standards

(a) The Board's auditing and related professional practice standards use certain terms set forth in this rule to describe the degree of responsibility that the standards impose on auditors.

(1) Unconditional Responsibility: The words "must," "shall," and "is required" indicate unconditional responsibilities. The auditor must fulfill responsibilities of this type in all cases in which the circumstances exist to which the requirement applies. Failure to discharge an unconditional responsibility is a violation of the relevant standard and Rule 3100.

(2) Presumptively Mandatory Responsibility: The word "should" indicates responsibilities that are presumptively mandatory. The auditor must comply with requirements of this type specified in the Board's standards unless the auditor demonstrates that alternative actions he or she followed in the circumstances were sufficient to achieve the objectives of the standard. Failure to discharge a presumptively mandatory responsibility is a violation of the relevant standard and Rule 3100 unless the auditor demonstrates that, in the circumstances, compliance with the specified responsibility was not necessary to achieve the objectives of the standard.

Note: In the rare circumstances in which the auditor believes the objectives of the standard can be met by alternative means, the auditor, as part of documenting the planning and performance of the work, must document the information that demonstrates that the objectives were achieved.

(3) Responsibility To Consider: The words "may," "might," "could," and other terms and phrases describe actions and procedures that auditors have a responsibility to consider. Matters described in this fashion require the auditor's attention and understanding. How and whether the auditor implements these matters in the audit will depend on the exercise of professional judgment in the circumstances consistent with the objectives of the standard.

Note: If a Board standard provides that the auditor "should consider" an action or procedure, consideration of the action or procedure is presumptively mandatory, while the action or procedure is not.

(b) The terminology in paragraph (a) of this rule applies to the responsibilities imposed by the auditing and related professional practice standards, including the interim standards adopted in Rules 3200T, 3300T, 3400T, 3500T, and 3600T.

(c) The documentation requirement in paragraph (a)(2) is effective for audits of financial statements or other engagements with respect to fiscal years ending on or after [insert date the later of November 15, 2004, or 30 days after approval of this rule by the Securities and Exchange Commission].

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

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

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

(a) Purpose.

The Commission understands from the PCAOB staff that Rule 1001(a)(xii) would define the term "auditor" to mean both public accounting firms registered with the Public Company Accounting Oversight Board and associated persons thereof. A similar definition was included in PCAOB Auditing Standard No. 1, *References in Auditors' Reports to the Standards of the Public Company Accounting Oversight Board* (approved by the SEC on May 14, 2004) and PCAOB Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction with An Audit of Financial Statements* (approved by the SEC on June 17, 2004). Instead of continuing to repeat the definition of this term in future standards, the Board approved the inclusion of this defined term in Rule 1001, *Definitions of Terms Employed in Rules*. Other than its use in these standards, the term "auditor" is not used in the Board's currently effective rules in a context in which this definition would apply. Accordingly, the definition in Rule 1001 does not change the meaning of any currently effective PCAOB rule or standard. Also, while the new definition of "auditor" in Rule 1001 would apply to any auditing and related professional practice standard established by the Board, including a PCAOB standard that amends an interim standard, it would not apply to the auditing and professional standards that the Board adopted as its interim standards in PCAOB Rules 3200T through 3600T. To

the extent the Board has amended an interim standard subsequent to its adoption, the definition in Rule 1001 would apply to the amended language of the interim standard but not to the unchanged language of that standard.

Section 103(a)(1) of the Act authorizes the PCAOB to establish, by rule, auditing standards to be used by registered public accounting firms in the preparation and issuance of audit reports, as required by the Act. PCAOB Rule 3100, "Compliance with Auditing and Related Professional Practice Standards," requires auditors to comply with all applicable auditing and related professional practice standards established by the PCAOB. 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*, as in existence on April 16, 2003 (the "interim standards").

The proposed rule sets forth terminology the Board will use in auditing and related professional practice standards established or adopted by the Board.

(b) Statutory Basis.

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

B. Board's Statement on Burden on Competition

The Board does not believe that the proposed rule will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. Pursuant to the Act and PCAOB Rule 3100, auditing and related professional practice standards established by the PCAOB must be complied with by all registered public accounting firms.

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

The Board released the proposed rule for public comment in PCAOB Release No. 2003-018 (October 7, 2003). A copy of PCAOB Release No. 2003-018 and the comment letters received in response to the PCAOB's request for comment are available on the PCAOB's Web site at <http://www.pcaobus.org>. The Board received 12 written comments. The Board has modified certain aspects of the proposed rule in response to comments it received, as discussed below:

Rule 3101(a)

The Board added the following captions to Rule 3101(a): 3101(a)(1) Unconditional Responsibility, 3101(a)(2) Presumptively Mandatory Responsibility, and 3101(a)(3) Responsibility To Consider. Proposed Rule 3101(a) did not have a caption or designation for each category of terms. Rather, the proposed rule simply referenced the category of certain terms by using the standard format in PCAOB rulemaking. The Board added the captions in response to a commenter's recommendation that a caption be added to each category of certain terms for ease of reference and clarity.

One commenter recommended replacing the term "obligation" in Rule 3101 with a comparable term because the commenter believed that the term "obligation" in legal and governmental environments has a connotation that is inconsistent with the intent of Rule 3101 and may be misinterpreted by legal or governmental officials. After considering this comment, the Board replaced the term "obligation" with the synonym "responsibility" in Rule 3101.

Rule 3101(a)(2) defines a presumptively mandatory responsibility as a requirement that the auditor must comply with "unless the auditor demonstrates that alternative actions he or she followed in the circumstances were sufficient to achieve the objectives of the standard." Furthermore, Rule 3101(a)(2) states that "failure to discharge a presumptively mandatory responsibility is a violation of the relevant standard and Rule 3100 unless the auditor demonstrates that, in the circumstances, compliance with the specified responsibility was not necessary to achieve the objectives of the standard."

The Board also added a note to Rule 3101(a)(2) to require auditors to document compliance with presumptively mandatory responsibilities by alternative means. The Board originally proposed that the auditor be required to "demonstrate by verifiable, objective, and documented evidence" that the alternative procedures he or she followed were sufficient in the specific circumstances. Commenters stated that they believed that the documentation requirement was important, both to promote discipline of thought and to provide a uniform basis for evaluating compliance with the standards. Several of these commenters went even further to recommend that the Board strengthen the documentation requirement by adding language such as "contemporaneous" and "memorialized at the time of the audit" to the rule.

Conversely, other commenters suggested that the documentation requirement was unduly onerous and placed too great a documentation burden on the auditors. The commenters argued that the documentation would be too voluminous and would add very little value to the audit. Some of these commenters further recommended that, in lieu of the proposed documentation requirement, the rule require that the auditor consider the significance of the particular audit area and document only the significant issues or findings. A commenter also recommended that other evidence, such as oral explanation, should be allowed as support for the reasons why the auditor chose not to perform a presumptively mandatory responsibility. Additionally, some commenters recommended that the documentation requirement should be addressed in the standard on audit documentation.

The integrity of the audit depends, in large part, on the existence of a complete and understandable record of the work performed, the conclusions reached, and the evidence obtained to support those conclusions. Clear, complete, and comprehensive audit documentation enhances the quality of the audit. Audit documentation should demonstrate compliance with professional standards and justify the reasons for any variations in procedures performed.

The PCAOB standards require the auditor to document the procedures performed, evidence obtained, and conclusions reached during an engagement. To further enhance the quality of the audit, Rule 3101(a)(2) adds a specific documentation requirement to achieve complete and comprehensive audit documentation in engagement working papers for situations in which the auditor does not perform a presumptively mandatory responsibility. In those instances, it is essential that auditors document the reasons they chose not to perform the presumptively mandatory responsibility and how the alternative procedure they performed sufficiently achieved the objectives of the specific standard.

Because circumstances will be rare in which the auditor will perform an alternative procedure, the Board anticipates that the documentation requirement in the rule ought not to result in unduly onerous consequences or too voluminous documentation. Furthermore, since the auditor must already document the work performed as part of the audit, adding a concise explanation as to why the auditor chose to perform the alternative procedure

should not increase the volume of documentation to an unreasonable level.

During an internal or external review of the engagement, other evidence, including oral explanation, may help substantiate the procedures performed by the auditor during the audit. However, because the auditor is required to document his or her work in the engagement working papers during the audit, oral explanation should be used only to clarify the documented work performed. The justification as to why the alternative procedure was performed rather than the presumptively mandatory responsibility must be documented in the working papers. Furthermore, the reviewer should give appropriate consideration to the credibility of the individual(s) providing the oral explanation, and the oral explanation should be consistent with the documented evidence in the engagement working papers.

Moreover, the Board concluded that applying the documentation requirement only to significant issues, findings, or procedures is impractical because it will not be efficient or effective to determine, each time, whether the level of significance of an audit area warranted the auditor to document the reasons for choosing to perform an alternative procedure instead of the presumptively mandatory procedure. The purpose of Rule 3101 is to bring uniformity to definitions and requirements that auditors have to follow. In addition, the Board determined that moving Rule 3101(a)(2)'s documentation requirement to the audit documentation standard would not be appropriate because of its specific subject matter.

Additionally, the Board has added a note, originally a footnote in the Board's proposing release accompanying its proposed rule, describing an auditor's responsibility in a "should consider" scenario to the text of Rule 3101(a)(3), Responsibility to Consider. Some commenters recommended that this footnote be added directly to the text of the rule because they saw it as an important clarification that was not included in the original proposed rule. A commenter further urged the Board to elaborate on its applicability and the documentation requirements for a "should consider" action.

Another commenter suggested that the "should consider" footnote be excluded from the rule because it implies that the action would require the auditor to document every instance of compliance with a "should consider" action. The commenter, instead, recommended that Rule 3101(a)(3) be revised to apply to all considerations

regardless of how the obligation is expressed (for example, whether it is preceded by a "should," "may," "could," or "might").

Because the "should consider" terminology is widely used in the interim standards, the Board determined that it is important to state the Board's expectation for compliance and, therefore, agreed with commenters who recommended adding the "should consider" footnote to the text of Rule 3101(a)(3). Furthermore, the Board concluded that there is an important difference between a "should consider" and a "may consider" action or procedure. The difference is a direct correlation to the definitions of "should" and "may." The auditor has a greater responsibility in a "should consider" action because the auditor has a presumptively mandatory responsibility to consider the action or procedure versus just having a responsibility to consider the action. Therefore, Rule 3101(a)(3) was not revised to apply to all considerations regardless of how the obligation is expressed.

Additionally, the Board determined that the documentation requirement relating to a procedure that an auditor "should consider" is not the same as the documentation requirement for a presumptively mandatory responsibility because in a "should consider" situation, only the consideration of the action is presumptively mandatory, while the action or procedure itself is not. In these situations, the auditor should use his or her professional judgment in determining how to document his or her consideration of the specific action or procedure.

Rule 3101(b)

Some commenters on the proposed rule stated that the imperatives the Board identified are consistent with the way auditors currently interpret existing auditing and related professional practice standards, while other commenters recommended that Rule 3101(a) not apply to the interim standards on the grounds that the new definitions could create confusion or have unintended consequences. Because the accounting profession previously had not expressly defined these terms, commenters further recommended that the Board perform a comprehensive analysis of how and in what context the interim standards use the defined terms to determine whether current practice is consistent with the Rule 3101(a) definitions.

The Board concluded that the terminology defined in Rule 3101 is consistent with the existing

interpretation regarding the application of the terminology in the interim standards. Rule 3101 creates a common understanding among the auditors as to what is expected of them when performing engagements in accordance with the PCAOB standards and, therefore, Rule 3101 will apply to the interim standards.

Furthermore, a commenter recommended that the Board clarify the level of authority the appendices carry when accompanying the Board's standards. Because the Board adopts the appendices to its permanent standards as rules, the appendices to the Board's permanent standards carry the same level of authority as the standards themselves. In addition, the appendices to the interim standards, which in certain circumstances carry a different level of authority, retain their original level of authority as adopted on April 16, 2003.

Rule 3101(c)

Rule 3101(c) establishes an effective date for the documentation requirement in paragraph (a)(2). The Board agreed with commenters who recommended establishing an effective date to provide a reasonable amount of time for auditors to implement procedures to properly comply with the new documentation requirement.

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

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

- (a) By order approve such proposed rule; or
- (b) Institute proceedings to determine whether the proposed rule should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule is consistent with Title I of the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/pcaob.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File

No. PCAOB-2004-06 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609.

All submissions should refer to File No. PCAOB-2004-06. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/pcaob.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Section, 450 Fifth Street, NW., Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of the PCAOB. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File No. PCAOB-2004-06 and should be submitted on or before August 23, 2004.

By the Commission.

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-50093; File No. SR-Amex-2004-56]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the American Stock Exchange LLC To Amend Alphabetical Designations of Paragraphs in Amex Rule 118

July 27, 2004.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934

("Act")¹ and Rule 19b-4 thereunder,² notice is hereby given that on July 26, 2004, the American Stock Exchange LLC ("Amex" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change, as described in Items I and II below, which Items have been prepared by the Exchange. The Exchange has filed this proposed rule change pursuant to section 19(b)(3)(A) of the Act³ and Rule 19b-4(f)(6) thereunder,⁴ which renders the proposal effective upon filing with the Commission. The Commission is publishing this notice to solicit comment on the proposed rule change from interested persons.

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

The Amex proposes to correct the alphabetical designation of paragraphs in Amex Rule 118. The text of the proposed rule change is available at the Commission and at the Amex.

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

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

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

1. Purpose

On April 30, 2003 the Exchange submitted a proposal amending Amex Rule 118 to adopt a clearly erroneous transaction rule and half-point error guarantee for trades in Nasdaq National Market Securities. By the time the Commission approved this filing on June 29, 2004,⁵ it had approved other changes⁶ to Rule 118 and the alphabetical designation of the new paragraphs to this rule were no longer

appropriate. This filing seeks to correct a formatting error and keep published rules organized.

2. Statutory Basis

The Amex believes the proposed rule change is consistent with section 6(b) of the Act⁷ in general and furthers the objectives of section 6(b) of the Act⁸ in particular in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest; and is not designed to permit unfair discrimination between customers, issuers, brokers and dealers.

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange believes that the proposed rule change will impose no burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants or Others

No written comments were solicited or received by the Exchange on this proposal.

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

The Exchange asserts that the proposed rule change is immediately effective pursuant to section 19(b)(3)(A) of the Act⁹ and Rule 19b-4(f)(6) thereunder¹⁰ because it: (1) Does not significantly affect the protection of investors or the public interest; (2) does not impose any significant burden on competition; and (3) does not become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate if consistent with protection of investors and the public interest.

The Exchange has requested the Commission to waive the 30-day operative delay and the five-day pre-filing notice requirement. The Commission believes waiving the 30-

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A).

⁴ 17 CFR 240.19b-4(f)(6).

⁵ See Securities Exchange Act Release No. 49941 (June 29, 2004), 69 FR 40992 (July 7, 2004) (SR-Amex-2003-39).

⁶ See Securities Exchange Act Release No. 49240 (February 12, 2004), 69 FR 8248 (February 23, 2004) (SR-Amex 2003-21).

⁷ 15 U.S.C. 78f(b).

⁸ 15 U.S.C. 78f(b)(5).

⁹ 15 U.S.C. 78s(b)(3)(A).

¹⁰ 17 CFR 240.19b-4(f)(6).