

in its report the city and state (or city and country, in the case of non-U.S. auditors) from which the auditor's report was issued.

Audit reports currently are required to state that the audits that supported those reports were performed in accordance with generally accepted auditing standards.<sup>4</sup> The PCAOB adopted those generally accepted auditing standards, including their respective effective dates, as they existed on April 16, 2003, as interim PCAOB standards. Therefore, changing the reference from "generally accepted auditing standards" to "the standards of the Public Company Accounting Oversight Board (United States)" does not change the substantive procedures performed by an auditor. Because GAAS and the standards of the PCAOB are one and the same for PCAOB-registered public accounting firms, the PCAOB believes that a reference to GAAS in auditors' reports would no longer be appropriate or necessary.

### III. Discussion

The Commission received five comment letters in response to its request for comments on Auditing Standard No. 1. Several commenters sought clarification with respect to certain implementation issues. One of the issues they raised is addressed in the Commission interpretive release discussed below. The Commission staff is aware of the other issues and will consider whether any guidance is needed in the future. One commenter recommended that the PCAOB undertake a near-term project to make conforming amendments to other standards affected by Auditing Standard No. 1, and another suggested changes to the form of auditor's report that were not related to the topic of this standard. We are forwarding these comments to the PCAOB for its consideration in future standard setting. Two commenters repeated an earlier suggestion to the PCAOB that the auditor's report should specify that the audit was conducted in accordance with the *auditing* standards of the PCAOB rather than using a reference that included all PCAOB standards, including quality control, ethics and independence standards. In response to the earlier comments, the PCAOB declined to limit the categories of standards that might be applicable to an audit, and the Commission concurs with that position.

In order to address certain issues relating to implementation of Auditing Standard No. 1, the Commission is

issuing an interpretive release simultaneously with the issuance of this order. The Commission believes that publication of the interpretive release will assist the PCAOB, registrants, auditors and investors by, among other things, addressing certain transitional implementation issues and clarifying the impact of Auditing Standard No. 1 on existing references in Commission rules and regulations to "generally accepted auditing standards."

### IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposed Auditing Standard No. 1 is consistent with the requirements of the Act and the securities laws and is necessary and appropriate in the public interest and for the protection of investors.

*It is therefore ordered*, pursuant to section 107 of the Act and section 19(b)(2) of the Securities Exchange Act of 1934, that proposed Auditing Standard No. 1, *References in Auditors' Reports to the Standards of the Public Company Accounting Oversight Board* (File No. PCAOB-2003-10) be and hereby is approved.

By the Commission.

**J. Lynn Taylor,**

*Assistant Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49704; File No. PCAOB-2003-07]

### Public Company Accounting Oversight Board; Order Approving Proposed Rules Relating to Investigations and Adjudications

May 14, 2004.

#### I. Introduction

On October 10, 2003, the Public Company Accounting Oversight Board (the "Board" or the "PCAOB") filed with the Securities and Exchange Commission (the "Commission") proposed rules pursuant to Section 107 of the Sarbanes-Oxley Act of 2002 (the "Act") and Section 19(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), relating to investigations and adjudications. Notice of the proposed rules was published in the **Federal Register** on March 26, 2004.<sup>1</sup> The Commission received five comment letters relating to these rules. For the reasons discussed below, the

Commission is granting approval of the proposed rules.

### II. Description

Section 105 of the Act directs the PCAOB to establish fair procedures for the investigation and disciplining of registered public accounting firms and associated persons of such firms. In furtherance of this provision, the PCAOB proposed rules to establish procedures for investigations and adjudications, and adopted the proposed rules on September 29, 2003. Pursuant to the requirements of section 107(b) of the Act and Section 19(b) of the Exchange Act, the Commission published the proposed rules for public comment on March 26, 2003. The proposed rules on investigations and adjudications consist of 64 rules (PCAOB Rules 5000 through 5469 and 5500 through 5501), plus certain definitions that appear in PCAOB Rule 1001.

The proposed rules on investigations and adjudications provide that the PCAOB and its staff may conduct investigations concerning any acts or practices, or omissions to act, by registered public accounting firms and persons associated with such firms that may violate any provisions of the Act, the rules of the PCAOB, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including Commission rules issued under the Act or professional standards. Pursuant to the Act, the PCAOB's proposed rules provide that it may require registered public accounting firms and their associated persons to cooperate with Board investigations and may seek information from other persons, including clients of registered firms.

When violations are detected, the proposed rules provide an opportunity for a hearing, and in appropriate cases, for the PCAOB to impose sanctions designed to prevent a repetition of the violation and to enhance the quality and reliability of future audits. These sanctions may include temporarily or permanently prohibiting a firm or associated person from participating in audits of public companies or from being associated with a registered public accounting firm. Sanctions also may require special remedial measures, such as training, new quality control procedures, and the appointment of an independent monitor.

The PCAOB also may hold hearings on disapproved registration applications, pursuant to Section 102 of the Act. Under the PCAOB's registration

<sup>4</sup> Item 2-02 (b) of Regulation S-X.

<sup>1</sup> Release No. 34-49454 (March 19, 2004).

rules, if the PCAOB is unable to determine that a public accounting firm has met the standard for approval of an application, the PCAOB may provide the firm with a notice of a hearing, which the firm may elect to treat as a written notice of disapproval for purposes of making an appeal to the Commission under Section 107(c) of the Act. If the firm chooses to request a hearing, the PCAOB would, in appropriate circumstances, afford the firm a hearing pursuant to its proposed rules relating to investigations and adjudications.

At the time the PCAOB approved the rules relating to investigations and adjudications, it separately approved, and submitted for Commission approval on an accelerated basis, a subset of those rules that were intended to serve as temporary hearing rules in the event the PCAOB decided to disapprove an application for registration while the Commission was still considering action on the rules relating to investigations and adjudications. The Commission approved the PCAOB's temporary hearing rules on an accelerated basis on November 10, 2003, with the expectation that if it approved the proposed rules relating to investigations and adjudications, those permanent rules would supersede and replace the temporary hearing rules.<sup>2</sup>

### III. Discussion

The PCAOB rules relating to investigations and adjudications generally establish a basic procedural framework for conducting investigations and disciplinary proceedings. Several of the comments the Commission received on the proposed rules reflected concern about the rules' lack of specificity with respect to certain matters left to the discretion of the PCAOB and its staff. These matters include, for example, the determination as to which persons will be permitted to be present during an investigatory examination. The Commission recognizes that the rules are broad in scope and that they contemplate the exercise of discretion by the PCAOB and its staff in a number of important areas. We fully expect the PCAOB and its staff to exercise this discretion in a balanced and fair-minded fashion with due regard for both the purposes of Section 105 of the Act and the legitimate concerns of the firms and individuals affected by the rules. The Commission also recognizes that the rules are new and undoubtedly will be revised and improved over time, as the PCAOB gains experience with their implementation. As this process

continues, we would encourage the PCAOB to consider carefully the concerns expressed by commenters and others affected by the rules.

The Commission previously indicated its concern with the operation of proposed Rule 5424(b), which would permit the PCAOB to request issuance of Commission subpoenas in connection with PCAOB disciplinary proceedings, either on the PCAOB's own behalf or for the benefit of the party that is the subject of the proceeding. The Commission notes, in connection with proposed Rule 5424(b), that the issuance of Commission subpoenas in connection with PCAOB disciplinary proceedings would be a novel and potentially complex arrangement, and the Commission staff has discussed with the PCAOB staff the need to develop and implement additional rules and procedures regarding the handling of subpoena requests. The two comment letters that addressed this issue supported the idea that respondents in a PCAOB hearing could ask the PCAOB to request a Commission subpoena to compel appearance by non-parties to the hearing. They agreed, however, that this procedure raised novel issues, and that the Commission and the PCAOB should adopt additional, carefully crafted rules to implement Rule 5424(b). The additional rules and procedures being developed by the PCAOB and Commission staffs would address, among other things, the steps that the parties to PCAOB proceedings would need to follow prior to applying for Commission subpoenas, as well as the Commission's processes for handling such requests once they are received. It is our understanding and expectation, which we have discussed with the PCAOB staff, that Rule 5424(b) will not be available for use in PCAOB proceedings until these additional rules and procedures have been developed and implemented to our satisfaction.

We are satisfied that the rules proposed by the PCAOB create a reasonable operating framework for investigating and disciplining registered public accounting firms and their associated persons.

### IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rules are consistent with the requirements of the Act and the securities laws and are necessary and appropriate in the public interest and for the protection of investors.

*It is therefore ordered*, pursuant to Section 107 of the Act and Section 19(b)(2) of the Exchange Act, that the proposed rules on investigations and

adjudications (File No. PCAOB-2003-07) be and hereby are approved (with the understanding that Rule 5424(b) will not be available for use in PCAOB proceedings until the appropriate implementation framework is in place), and that such rules, as of the date of this approval, supersede and replace the temporary hearing rules (File No. PCAOB-2003-06) in their entirety.

By the Commission.

**J. Lynn Taylor,**

*Assistant Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49700; File No. SR-Amex-2004-12]

### Self-Regulatory Organizations; Order Granting Approval of Proposed Rule Change by the American Stock Exchange LLC Relating to Audit Committee Meeting Requirements Applicable to Registered Closed-End Management Investment Companies

May 13, 2004.

#### I. Introduction

On February 13, 2004, the American Stock Exchange LLC ("Amex" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend Section 121 of the Amex *Company Guide* to modify the audit committee meeting requirements applicable to registered closed-end management investment companies ("closed-end funds"). On March 12, 2004, the Commission published the proposed rule change for comment in the **Federal Register**.<sup>3</sup> The Commission received one comment letter on the proposal.<sup>4</sup> This Order approves the proposed rule change.

#### II. Description of the Proposed Rule Change

In December 2003, the Commission approved a broad array of enhancements to the corporate governance requirements applicable to companies

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 49371 (March 5, 2004), 69 FR 11919 (March 12, 2004).

<sup>4</sup> Letter from Dorothy M. Donohue, Associate Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, Commission, dated March 31, 2004 ("ICI Letter").

<sup>2</sup> Release No. 34-48765 (November 10, 2003).