

expect the discussions to include the reasons why the accountant considered one policy to be preferred but that policy was not selected by management.

The separate discussion of critical accounting policies and practices is not considered a substitute for communications regarding general accounting policies, since the discussion about critical accounting policies and practices might not encompass any new or changed general accounting policies and practices. Likewise, this discussion of general accounting policies and practices is not intended to dilute the communications related to critical accounting policies and practices, since the issues affecting critical accounting policies and practices, such as sensitivities of assumptions and others, may be tailored specifically to events in the current year, and the selection of general accounting policies and practices should consider a broad range of transactions over time.

### 3. Other Material Written Communications

We understand written communications between accountants and management range from formal documents, such as engagement letters, to informal correspondence, such as administrative items. We also acknowledge that historically not all forms of written communications provided to management have been provided to the audit committee. Our rule is intended to implement Section 205 of the Sarbanes-Oxley Act, which clarified the substance of information that should be provided by accountants to audit committees to facilitate accountant and management oversight by those committees.

The Sarbanes-Oxley Act specifically cites the management letter and schedules of unadjusted differences as examples of material written communications to be provided to audit committees. Examples of additional written communications that we expect will be considered material to an issuer include:

- Management representation letter;<sup>211</sup>
- Reports on observations and recommendations on internal controls;<sup>212</sup>
- Schedule of unadjusted audit differences,<sup>213</sup> and a listing of

adjustments and reclassifications not recorded, if any;

- Engagement letter;<sup>214</sup> and
- Independence letter.<sup>215</sup>

These examples are not exhaustive, and accountants are encouraged to critically consider what additional written communications should be provided to audit committees.

### 4. Timing of Communications

Commenters<sup>216</sup> generally agreed with our proposal that the communications should occur prior to the filing of the issuer's periodic annual report, although a commenter<sup>217</sup> suggested that the communications should occur throughout the period. The Act requires that the communications be timely reported to the audit committee. For purposes of the requirements of this provision, our rule specifies that the communications between the accountant and the audit committee occur prior to the filing of the audit report with the Commission pursuant to applicable securities laws. As a result, these discussions will occur, at a minimum, during the annual audit, but we expect that they could occur as frequently as quarterly or more often on a real-time basis.

The timing of these communications is intended to occur before any audit report is filed with the Commission pursuant to the securities laws. We believe that this rule will ensure that these communications occur prior to filing of annual reports and proxy statements, as well as prior to filing registration statements and other periodic or current reports when audit reports are included.

### 5. Investment Companies

The proposed rules would have required accountants to communicate with an audit committee of an investment company all critical accounting policies, alternative methodologies and other material information before filing an audit report with the Commission. Although commenters<sup>218</sup> generally agreed that the

information required to be communicated was appropriate, the timing of such communications would be problematic for investment companies. Commenters<sup>219</sup> stated that investment companies within an investment company complex frequently have a common board of directors, but have staggered fiscal-year ends. As a result, the proposed rules could require accountants to communicate with audit committees as frequently as monthly. To eliminate this burden, some commenters<sup>220</sup> suggested these discussions occur as infrequently as annually, with two commenters<sup>221</sup> suggesting updates for material changes. Another commenter<sup>222</sup> suggested that we leave communication of these matters up to the discretion of the investment company's audit committee and the accountant.

We believe it is important to discuss critical accounting policies, alternative methodologies, and other material information close to the time when the audit report is filed. It is not our intention, however, to have accountants communicate the same information to the audit committee multiple times during the year. As adopted, the final rules require the accountant to communicate to the audit committee of an investment company annually, and if the annual communication is not within 90 days prior to the filing, provide an update in the 90 day period prior to the filing, of any changes to the previously reported information.<sup>223</sup>

The adopted rules, in effect, would require an accountant of an investment company complex where the individual funds have different fiscal year ends to communicate the required information no more frequently than four times during a calendar year. We believe this should not place an undue burden on investment company audit committees because many of the boards of directors

Institute, dated January 13, 2003; letter from PricewaterhouseCoopers, dated January 8, 2003.

<sup>219</sup> See, e.g., letter from The Vanguard Group, dated January 13, 2003; letter from Investment Company Institute, dated January 13, 2003; letter from Ernst & Young, dated January 6, 2003.

<sup>220</sup> See, letter from The Vanguard Group, dated January 13, 2003; letter from Investment Company Institute, dated January 13, 2003; letter from PricewaterhouseCoopers, dated January 8, 2003.

<sup>221</sup> See, letter from Investment Company Institute, dated January 13, 2003; letter from The Vanguard Group, dated January 13, 2003.

<sup>222</sup> See, letter from Ernst & Young, dated January 6, 2003.

<sup>223</sup> The rule also would require communication of a description of all non-audit services provided, including fees associated with the services, to the investment company complex that were not subject to the pre-approval requirements for investment companies as discussed in Section II.D of this release.

<sup>211</sup> See, SAS No. 85, "Management Representations," AU § 333.

<sup>212</sup> See, SAS 60, "Communication of Internal Control Related Matters Noted in an Audit," AU § 325.

<sup>213</sup> See, SAS No. 89, "Audit Adjustments," AU § 333.

<sup>214</sup> See, SAS No. 83, "Establishing an Understanding With the Client," AU § 310.

<sup>215</sup> See, SQCS No. 2, "System of Quality Control for a CPA Firm's Accounting and Auditing Practice," QC § 20.

<sup>216</sup> See, e.g., letter from California Public Employees' Retirement System, dated January 10, 2003; letter from Computer Sciences Corporation, dated January 13, 2003; letter from American Institute of Certified Public Accountants, dated January 9, 2003; letter from PricewaterhouseCoopers, dated January 8, 2003.

<sup>217</sup> See, e.g., letter from Lynn E. Turner, dated January 13, 2003.

<sup>218</sup> See, letter from The Vanguard Group, dated January 13, 2003; letter from Investment Company