

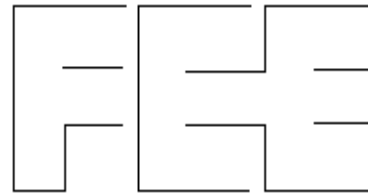
Date  
26 January 2004

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Général

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Office of the Secretary  
Public Company Accounting Oversight Board (PCAOB)  
1666 K Street, NW  
USA - Washington D.C. 20006-2803



Dear Sirs,

**Re: PCAOB Rulemaking Docket Matter No. 013 – “Proposed Rules Relating to the Oversight of Non-U.S. Public Accounting Firms”**

FEE (Fédération des Experts Comptables Européens – European Federation of Accountants) is pleased, as the representative organisation of the European accountancy profession, to comment on the exposure draft released by the PCAOB on 10 December 2003 on “Proposed Rules Relating to the Oversight of Non-U.S. Public Accounting Firms” (referred to as “the proposed rules”).

FEE shares the objectives of the PCAOB to enhance the efficient functioning of the capital markets, to protect investors and to help restore public trust in the auditing profession by improving audit quality and by ensuring effective and efficient oversight of audit firms. FEE is generally supportive of the overall intention of the PCAOB to develop co-operative arrangements with its foreign counterparts to enable it to place reliance on the home country systems for registration, inspections, investigations and adjudications.

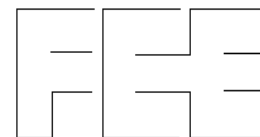
We are in favour of high level principle-based standards which we believe will also form the basis for the soon to be proposed revised European Commission Eighth Company Law Directive. A principle-based framework, with sufficient credible detail, allows for the use of judgement concerning the different ways in which oversight and quality assurance arrangements can apply principles effectively and recognizes the need for a proper transparent process and robust discussion.

However, we regret that the proposed rules do not support “mutual co-operation with other high quality regulatory systems that respects the cultural and legal differences of the regulatory regimes that exist around the world” announced in the PCAOB Briefing Paper on “Oversight of non-U.S. Public Accounting Firms.”

We consider this to be the crucial point. FEE is firmly of the view that robust oversight is most effectively provided in the public interest at national level, provided that within the EU there is also a body charged with co-ordination and that there is effective global co-operation. Our discussion paper on oversight, issued in September 2003, clearly stated the European profession’s commitment to oversight at the highest level of rigour and, as to co-ordination, went further than the proposals of the European Commission set out in its Communication in May 2003.

The stance taken by the PCAOB on oversight will be a crucial element in a successful outcome in terms of public and investor confidence in the audit function in the EU. If it in effect largely ignores the established or developing systems for quality assurance in the EU, or rates certain systems as weak because of the way in which they achieve shared objectives, this is unlikely to contribute to the most effective oversight possible and its rapid further development where necessary.

Limited co-operation, based only on the PCAOB model, offers a difficult prospect. Audits of listed companies in the EU may take on a different value in terms of quality (thus itself perhaps undermining the public perception of all audits). There is a risk of unseemly litigation between European firms or oversight bodies and the PCAOB, driven by the imperatives of some future scandal and conflicts



between PCAOB rules and national law. There might also, in a particular case, be the risk of inconsistent findings between a national oversight system and the PCAOB. Overall, limited co-operation offers ineffective solutions. In such a scenario, the benefits of continuous development of existing systems could well be lost.

By contrast, FEE supports a co-operative approach that builds on what has already been achieved in the European Union and, if judged necessary, identifies how regimes in individual EU countries could meet the highest level of PCAOB's specific assessment within a short period of say three years. The PCAOB has many good ideas to bring to this process and European systems of quality assurance and oversight also have much valuable knowledge to share. The higher the level of co-operation the more likely it is that audit regulation will be effective and efficient and the less likely it is that issues will be missed. FEE therefore encourages the PCAOB to be actively engaged with European Union initiatives to improve European quality assurance.

Because of the importance of the issues raised by the proposed rules we are sending a copy of our response to the International Federation of Accountants (IFAC) and the European Commission.

In addition to our overall comments on matters of principle, this letter includes comments on specific paragraphs.

## **Overall comments**

### **Status of explanatory material in the release**

The status of the explanatory material in the release on Pages 2 to 16 of the proposed rules, as well as the information given in the Section-by-Section-analysis in Appendix 2, is unclear. We would appreciate further clarification as to whether the additional guidance included in these pages and Appendix 2 will be included and binding upon the PCAOB in the final rule.

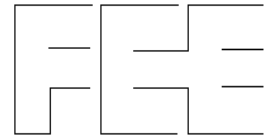
Generally, we would welcome more transparency in the standard setting process that is adhered to by the PCAOB. Specifically, a statement providing clarity on the authority of the PCAOB rules and other pronouncements would be most helpful.

### **Lack of overall transparency**

We have serious concerns about the surprising general lack of transparency in the evaluation process that the PCAOB will apply to determine the independence and rigour of a non-U.S. oversight systems under the proposed rules. The reasons for this concern are twofold:

- (1) The description of the five criteria for determining the independence and rigour of a non-U.S. system is not included in the rules themselves but only in the "Section-by-Section Analysis" and it is indicated that these criteria are intended as illustrative only and are not exhaustive; and
- (2) No reference is made to, and no information is included on, the benchmarks that will be used to evaluate an oversight system against these criteria.

We believe that the PCAOB's far-reaching discretion, enhanced by the frequent use of "may" in the context of placing reliance on a non-U.S. oversight system, will result in unintended uncertainty with respect to the evaluation by the PCAOB of any particular oversight system and therefore may be detrimental to the desired co-operative approach.



Proposed rule 4011 (c) (2) indicates that it is the PCAOB's intention to take into account "*any other information* that the Board may obtain concerning the level of the non-U.S. system's independence and rigor" to determine the degree of reliance on the non-U.S. inspection. It is understood, perhaps incorrectly, that this would be the case without any corresponding feedback and discussion with the jurisdictions' appropriate entity or entities regarding this other information, as such a procedure is not clearly described in the proposed rules. We suggest that the PCAOB should further clarify what is to be understood by "any other information". We also suggest that the PCAOB should be required to discuss such other information and its influence on the evaluation of and subsequent reliance on the non-U.S. system with the appropriate entity or entities, thus allowing the opportunity to identify potential improvements and to avoid potential misunderstandings.

The Section-by-Section Analysis included in Appendix 2 states in the first paragraph on page A2-3 that "Although not stated in the Rule (4011), ..., the Board would consider criteria, for example, as described below, that indicate a non-U.S. system's comportment with the principles set forth in the Rule." We urge the PCAOB to include the criteria or principles as described in Appendix 2 in proposed Rule 4011 and to include information on the benchmarks which will be used to evaluate not only a petition for an oversight system but also "any other information" as further specified in our previous paragraph against these criteria or principles. Such transparency is desirable for instance to avoid the appearance of treating one jurisdiction's oversight system inconsistently from any another jurisdiction's system.

### **Exclusively regulator-to-firm approach is inadequate for evaluation of oversight systems**

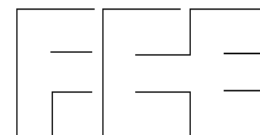
The proposed Rule 4011 (a) indicates that "*a foreign registered public accounting firm* that is subject to an inspection under the laws, rules, or professional oversight system in the jurisdiction in which it is organised and operates may request that the Board rely on that inspection in conducting an inspection of the firm...". In the written petition the foreign registered public accounting firm "*describes the non-U.S. system's laws, rules and/or other information to assist the Board in evaluating such system's independence and rigor.*"

This is a reasonable starting point for the evaluation process but the consequential need for interaction between the PCAOB and the home country oversight system is not clearly and explicitly addressed in the proposed rules. For example, proposed rule 4011 (c) (2) simply indicates that the PCAOB will evaluate "*any other information the Board may obtain concerning the level of the non-U.S. system's independence and rigor...*" whereas proposed Rule 4011 (c) (3) more appropriately refers to "*discussions with the appropriate entity or entities within the system concerning an inspection work program.*"

We can support the option for a firm to request the PCAOB to rely on its home country oversight system and to submit a high level description of that system. However, the requirement for each individual foreign registered public accounting firm to submit detailed descriptions of the non-U.S. system's laws, rules and so on is neither practical nor fully cost-effective. We also fail to see any corresponding benefit to the public interest. In our opinion this requirement for individual firms is also in contrast with the PCAOB's stated intention on Page 8 of the Release "... to develop an efficient and effective co-operative arrangement ..." and to allow the Board to allocate its resources in the most cost-effective manner. It is surely inappropriate and insufficient that the detailed information requirement is for each of the individual audit firms to fulfil instead of the PCAOB obtaining all the details that are required from the oversight bodies in each jurisdiction.

We believe that such a co-operative arrangement should consistently be applied on a regulator to regulator basis and is a matter for the PCAOB and the oversight authorities in any given jurisdiction and not for the individual audit firms.

We believe that the PCAOB would itself be faced with the risk of duplicated and even somewhat inconsistent information if several individual firms were to submit their own private descriptions and



translations in respect of one and the same system. Moreover this requirement would lead to excessive cost and efforts on the part of each public accounting firm as well as for the PCAOB.

### **Confidentiality and data protection issues**

Certain requirements in respect of inspections and investigations and adjudications which are not proposed to be amended for non-U.S. public accounting firms in the proposed rules are likely to conflict directly with confidentiality requirements and data protection legislation. The practical impossibility of obtaining all of the relevant consents to share information casts serious doubt on the ability of *any* audit firm in many EU jurisdictions to comply with all the proposed rules. This could have a severe impact on investor confidence, the credibility of audited financial statements and even perhaps the standing of the PCAOB.

The general “duty to co-operate with inspectors” and “... comply with any request ... to provide access to, and the ability to copy, any record in the possession, custody, or control of such a firm ...” (Rule 4006) will inevitably result in legal conflicts concerning confidentiality obligations and data protection issues. Similar issues will arise in cases where the PCAOB requires “Testimony of registered public accounting firms and associated persons” (Rule 5102) and “Production of audit work papers and other documents” in investigations (Rule 5103).

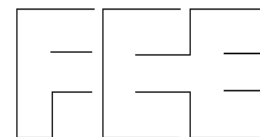
As the proposed rules include no provision for exemption, a registered public accounting firm will apparently not be permitted to object to, or not comply with, any requests which the PCAOB subsequently may make based on the reason that the request infringes its jurisdiction’s law. With respect to inspections, investigations and adjudications there does not appear to be an exemption rule similar to Rule 2105 “Conflicting non-U.S. laws” that permits an applicant to withhold information from its application for registration when submission of such information would cause the applicant to violate a non U.S. law. Therefore, it seems necessary expressly to include such an exemption in amendments to the proposed rules for inspections, investigations and adjudications for foreign registered public accounting firms.

Similarly, confidentiality requirements and data protection legislation will result in the difficulty for many of the public accounting firms in the Member States of the European Union to provide all the information which the PCAOB may request in future. Although we appreciate the PCAOB’s proposal to amend the Registration Rule 2100 to provide a three-month extension of the registration deadline for foreign public accounting firms, this does not resolve the basic issue of confidentiality and data protection described above. Registration with the PCAOB would subject not only European Union public accounting firms, but perhaps also the oversight authorities in their jurisdiction, to PCAOB rules in circumstances where they were unable to comply with them in significant respects due to local legislative restrictions.

It is particularly in respect to these potential conflicts of law that we regret that the constructive determinations as included in “Potential Conflicts of Law” in the PCAOB Briefing Paper on “Oversight of Non-U.S. Public Accounting Firms” seem not to have been retained.

### **Lack of consideration for quality aspects of non-U.S. oversight systems**

The PCAOB has included in the release paper and proposed rules certain criteria intended to be used in its evaluation of the independence and rigour of a particular home country oversight system. We are concerned that the examples of such criteria to assess the adequacy and integrity of the home country system are based primarily, if not indeed exclusively, on the U.S. system for inspections and investigations and adjudications of U.S. public accounting firms. Perhaps it is thought that an oversight system of any other kind cannot readily be considered consistent with the PCAOB’s mandate under the Sarbanes Oxley Act, although this is not mentioned in the proposed rules. Such an appreciation would



appear inconsistent with the tone of the Briefing Paper and the wide discretions afforded the PCAOB under the Act.

Although we appreciate that the PCAOB evaluation criteria will necessarily include comparison with the U.S. system, the PCAOB should be prepared to acknowledge that established non-U.S. systems, whilst different in form and details from the U.S. system, may, with perhaps some improvements, be equally effective and efficient in operation as the U.S. system may itself prove to be. Therefore we suggest that the PCAOB amends the rules and guidance thereon to allow a constructive evaluation of any given oversight system in its entirety and not merely consider whether it has the same features as the U.S. system. The proposed approach as currently drafted does not seem to us adequately to take into account provision for the various forms of regulatory systems resultant from different legal traditions in jurisdictions outside the U.S., nor does it appear to provide a means of building on established systems.

It is also in this respect that we regret that the PCAOB has not retained its recognition as included in the PCAOB Briefing Paper on “Oversight of Non-U.S. Public Accounting Firms” “that not all jurisdictions have inspection programs that are independent of the auditing profession” and “that the co-operative approach it envisages would accommodate the variety of inspection systems found around the world”.

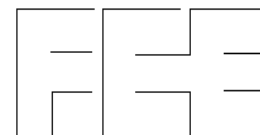
We advocate that the main criteria for an efficient and effective oversight system should be professional competence and independence, criteria which are applied in European oversight systems in order to adhere to the minimum requirements of the Recommendation on Quality Assurance for Statutory Audits in the European Union, which the European Commission released in November 2000. These requirements are intended to become part of the modernised Eighth European Union Company Law Directive, which is currently under revision. The last paragraph starting on Page A2-3 in the Section-by-Section Analysis included in Appendix 2 focuses on ensuring that the auditing and accounting profession will not be in the majority amongst the individuals with whom the system’s decision-making authority resides. We are supportive of this requirement but equally urge the PCAOB to focus also on the professional competence and knowledge of such individuals. We believe that it is essential that an adequate number, but not a majority, of such individuals has current technical and practical professional experience in the areas of accounting, auditing, ethics and quality assurance standards.

### **Inconsistent reliance upon non-U.S. inspection versus non-U.S. investigation**

The PCAOB Briefing Paper on “Oversight of Non-U.S. Public Accounting Firms” indicated that under the co-operative approach the PCAOB would be able to place full reliance on non-U.S. oversight systems in appropriate circumstances both for inspections and for investigations and sanctions.

We regret that in the Section-by-Section Analysis included in Appendix 2 on Pages A2-2 to A2-6 and in the explanatory material included in the Release on Pages 6 to 14 of the proposed rules the possibility of full reliance on non-U.S. oversight systems for inspections has not been retained, as they provide that the PCAOB will always play an active role in the process, both related to the selection of the individual audit files to be inspected and the effective execution of the quality assurance engagement itself. This seems to be in contrast with the Section-by-Section Analysis included in Appendix 2 on Pages A2-6 and A2-7 and in the explanatory material included in the Release on Pages 14 and 15 of the proposed rules which allow for reliance in appropriate circumstances upon the investigation or a sanction of a foreign registered accounting firm by a non-U.S. authority.

This apparent inconsistency in reliance upon non-U.S. oversight authorities in respect of inspection versus investigation and sanctions merits reconsideration in favour of restoring the possibility for full reliance on inspections performed by non-U.S. authorities or at least further clarification.



## **Involvement of government and the accounting profession**

The last paragraph starting on Page A2-3 in the Section-by-Section Analysis included in Appendix 2 indicates that “In assessing the independence of the non-U.S. system’s operations from the auditing profession, the Board would consider, for example, whether the individual or individuals with whom the system’s decision-making authority resides have been appointed, or otherwise selected, by the *government* of the non-U.S. jurisdiction.”

It should be noted that in certain Member States of the European Union independence of such individuals might be assured otherwise. They might for instance have been appointed by an oversight body independent from both the profession and the government under arrangements established or approved by the government. We repeat that we believe that the main criteria for an efficient and effective oversight system are professional competence and independence, as described in more detail under the general comment on “Lack of consideration for qualities of non-U.S. oversight system”, and we urge the PCAOB to take these alternatives fully into consideration in its deliberations.

## **Need for due process**

As indicated in the general comment on “Lack of overall transparency”, the PCAOB’s discretion in evaluating and determining the level of reliance on a non-U.S. oversight system is far-reaching with no apparent opportunity for discussion with, or a hearing of, the appropriate entities. This will inevitably result in uncertainty about the fairness of the evaluation process and the consistent treatment of different jurisdictions’ oversight systems.

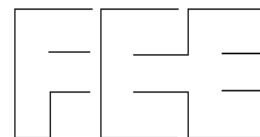
It is therefore essential that a due process be described in the rule providing for co-operative discussion with the entities under consideration, feedback on the PCAOB’s decisions and even a hearing between the PCAOB and such entities, or a right of appeal. Currently the only recourse possible seems to be an appeal in a U.S. court. Such a process would be more likely to foster the sharing of knowledge and good practice between oversight authorities and so promote regulatory convergence at the highest level.

The body charged with hearing any appeal would be expected objectively to review, assess and conclude on the initial decision to which exception is taken, together with the supporting conclusions, reasons and findings.

We therefore urge the PCAOB to include the rights of discussion, hearing, feedback and appeal in amendments to the proposed rules for registration, inspections, investigations and adjudications for foreign registered public accounting firms.

## **Lack of definitions**

The term “inspection” has not been defined in the PCAOB Rules 4000 “Inspections” or in the amendments to such rules for non-U.S. public accounting firms currently proposed. As the term “inspections” is not widely used in Europe, a definition or further clarification would be helpful. We commonly use the term “quality assurance” to refer to a continuous process of monitoring the quality of the work performed by audit firms, using a wide range of instruments including visits to firms. We do not know whether this is the meaning of “inspections”.



## Comments on Specific Paragraphs

### **Appendix 2 – Section-by-Section Analysis of Proposed Amendments to Board Rules, Page A2-3, last paragraph and Page A2-4, paragraphs 2 & 3.**

The wording “whether a majority of the individuals with whom the *system’s decision-making authority* resides, ...“ is used a number of times. We suggest to include further clarification of the subject of the “system’s decision-making” which might be various issues such as appointments and inspections.

This is especially relevant in the context of our general comments on “Involvement of government and accountancy profession” as a system with a single decision-making body (as is the PCAOB) is not common in a number of Member States of the European Union, where decision-making is quite appropriately dispersed over different bodies subject to public oversight.

### **Appendix 2 – Section-by-Section Analysis of Proposed Amendments to Board Rules, Page A2-5, paragraph 2.**

It should be noted that, as is the case in the U.S., oversight and quality assurance systems have been strengthened or introduced recently or will be introduced shortly in a number of Member States of the European Union with the aim of helping to restore the public trust in the auditing profession.

Therefore, not all such systems will have been in existence long enough to have established a basis for evaluating past performance. We would appreciate it if the PCAOB acknowledged this. We would appreciate if the PCAOB could also acknowledge that an initial lack of a historical record of performance will not be detrimental to the general evaluation of the reliance to be placed on such oversight system. This would seem only fair, especially given that the PCAOB is itself recently established.

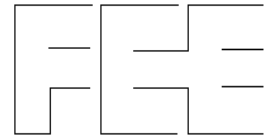
### **Appendix 2 – Section-by-Section Analysis of Proposed Amendments to Board Rules, Page A2-7, paragraph 1.**

It is stated that, in addition to the investigation and sanctions by a non-U.S. authority, “Proposed PCAOB Rule 5113 does not limit the Board’s authority under Rule 5200 to commence disciplinary proceedings whenever it appears to the Board that such action is warranted”. It should be noted that double sanctioning is a clear case of double jeopardy, which may be criticised from a human rights perspective.

We regret that the recognition of foreign sanctions appears minimal, since the PCAOB considers that non-U.S. sanctions do not in any way limit its authority, whereas it also suggests that non-U.S. jurisdictions may wish to rely upon sanctions imposed by the PCAOB on a U.S. registered public accounting firm.

### **D. Co-operation by the Board With Respect to its Non-U.S. Counterparts’ Auditor Oversight Responsibilities, Page 15 of the Release Paper, paragraph 1.**

The PCAOB indicates that “it would assist in the inspection of U.S. firms that audit or play a substantial role in the audit of public companies in non-U.S. jurisdictions. In order not to compromise the Board’s independence, however, the Board intends to provide a level of assistance that is consistent with the Board’s determination regarding the non-U.S. oversight system’s independence and rigor.”



Further clarification of the PCAOB's intention would be helpful as the statement above could be understood to overlook completely the common objective of the PCAOB and non-U.S. oversight systems to protect investors, improve audit quality, ensure effective and efficient oversight of audit firms, help restore public confidence in the auditing profession and buttress the efficient functioning of the capital markets. Indeed, where the rigour and independence of the non-U.S. oversight system is considered by the PCAOB to be minimal, we would expect the PCAOB to supplement the non-U.S. oversight systems by assuming a major role in the inspection of the U.S. audit firm rather than the opposite.

**E. Continuance of the Dialogue and Other Board Programs, Page 16 of the Release Paper.**

It is indicated that "the Board anticipates continuing its dialogue with oversight bodies outside of the United States ... to try to find ways to coordinate in areas where there is a common programmatic interest". We would welcome further clarification as to what is meant by "common programmatic interest" and how such a dialogue can be made transparent to all the stakeholders involved.

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If you have any further questions about our views on these matters, do not hesitate to contact us.

Yours sincerely,

David Devlin  
President