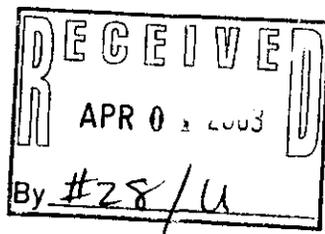




Department of  
Trade and Industry



Enquiries 020 7215 5000  
Direct line 020 7215 0223

URL <http://www.dti.gov.uk/>  
E-mail [john.grewe@dti.gsi.gov.uk](mailto:john.grewe@dti.gsi.gov.uk)

28 March 2003

Office of the Secretary  
Public Company Accounting Oversight Board  
1666 K Street  
WASHINGTON DC  
USA

Dear Secretary

**RULEMAKING DOCKET MATTER 01  
PROPOSAL FOR REGISTRATION SYSTEM FOR PUBLIC ACCOUNTING  
FIRMS**

My Minister, Melanie Johnson MP, the UK Minister for Competition, Consumers and Markets, and other UK colleagues were very pleased to meet members of the Board and some of the PCAOB staff in Washington a few weeks ago. We felt that this was a very helpful initial discussion and we think it is important that there is further contact and discussion between you and UK regulators on the issues raised in the proposal you published on March 7. We welcome the opportunity to participate in the Round Table organised for 31 March.

2. The issues raised are important ones for the UK, not least given the significant number of UK companies which are SEC registrants; and, we suspect, the number of UK companies which are subsidiaries of major US



INVESTOR IN PEOPLE

**dti**

Department of Trade and Industry



companies. We comment below on some of the principal issues raised by that document. We also attach a short Annex describing the regulatory and oversight regime for registered auditors in the United Kingdom. From our discussions we know that you already have a good idea of these and in particular what the UK Government is doing to strengthen these arrangements further. We would obviously be very pleased to provide more detailed information and to discuss this with you further.

3. We are also aware that UK bodies, in particular the Institute of Chartered Accountants in England and Wales, have made submissions to the PCAOB. We are strongly supportive of the problems and difficulties raised by the ICAEW and other commentators from overseas, in relation both to the principle of registration for all relevant overseas accounting firms and to the particular difficulties – both practical and legal – seen to stand in the way of proceeding to registration in the way and in the timescale suggested. We are encouraged in the belief that you are keen to find sensible ways forward and would urge you to pay close regard to the concerns which are being expressed not only from the UK, but also from the European Commission and other European colleagues, as well as more widely. In our view it would be a mistake – and probably simply not possible - to proceed with the registration of foreign accounting firms on your domestic timescale. We would suggest that you exercise the powers with the Sarbanes-Oxley at least to give significantly more time to work out proposals on the regulation of foreign accounting firms. We doubt that an additional six months provides enough time and we would urge you to give a further 12 months to agree a sensible way forward in respect of foreign accounting firms.

**General Proposition that Overseas/UK Accounting Firms should have to register with PCAOB.**

4. We recognise that the PCAOB has to take forward these issues within the remit set by the Sarbanes-Oxley Act and share many of the objectives of that Act in terms of improving the regulatory regime for audit and accounting firms.



5. In broad terms the existing approach to regulation as between US and many overseas countries such as the UK has been based on an implied mutual recognition of each other's regulatory regimes and laws ( We recognise of course that the SEC already imposes some US specific requirements on audit firms – in respect of auditor independence for example, and more recently on the use of US auditing standards. We have from time to time expressed our view to SEC colleagues that even these requirements should not be necessary in respect of a country such as the UK, where there is a well developed system of standards and regulation.)

6. Against this background we believe that the imposition of a general requirement of registration on the overseas auditors both of SEC registrants or of "significant" subsidiaries is a backwards step in a world which is increasingly inter-related and in which the mutual acceptance of equivalent arrangements is more rather than less desirable. We believe that the proposal to apply this in respect of the auditors of overseas subsidiaries is particularly intrusive of other countries' arrangements.

7. Registration in the way proposed also paves the way for a double system of oversight, which is potentially highly wasteful of resources, leads to conflicts when different regulatory systems reach different conclusions and creates possibility of double jeopardy for audit firms and individual auditors.

8. We have a particular concern that a complicated and expensive system of registration can only deepen the hold of the Big 4 firms on the audit market, just at the time when we are all anxious to find ways of encouraging second tier firms to grow their audit business. The costs and difficulties of registration are disproportionate generally for overseas audit firms, but even more so for firms outside the Big 4. And such firms are more likely to be the auditors of for example the UK subsidiaries of US registrants.

9. One possible way forward might be to identify principles, against which to judge whether regulatory arrangements are equivalent. This could provide the basis for agreeing equivalence across a wide area such as the European Union, or in respect of particular countries such as the UK or Ireland. It might also be an option for the PCAOB to provide for possible



exemption from registration in respect of individual foreign accounting firms, on the basis of information about them and about the local regulatory arrangements to which they are subject.

### **Practical difficulties for foreign firms in registering**

10. Even had we no difficulties with the principle of registration, we would need to emphasise, on the basis of our discussions with UK audit firms and with colleagues in Europe, that we see very substantial difficulties in the way of developing and implementing a registration regime for affected overseas firms within the timetable set out in the Sarbanes Oxley Act. Some of these points are mentioned below but we note that many are addressed in more detail in other submissions to the Board from the UK and elsewhere:

11. Some of the information required may not be publicly available in home country, or may be sensitive. But there is no clear commitment from PCAOB to keep such information confidential. There are likely to be all sorts of difficulties unless the PCAOB can give a clear commitment not to disclose information which would not otherwise be publicly available.

12. The information required has been developed, perfectly understandably, with US in mind. Some of it may not be readily understandable in other countries; or it may simply not be appropriate. We think this needs much more careful thought.

13. We get the flavour of a shopping list of items which might just be needed.

14. There are also legal difficulties in the way of providing some of the information. Our understanding is that these problems may not be as marked in the UK as in some other EU countries, but at the very least there is a problem with providing "personal data" which is protected under the EC Directive on data protection - there would need to be at the very least negotiation with the EU and/or with individual countries on how to provide a proper level of protection for such data.



15. As already mentioned, registration imposes disproportionate costs on overseas firms, partly because the information may be more difficult to put together and partly because the foreign firm is likely to have proportionately fewer US registrants.

16. We are particularly concerned at the difficulties registration would pose for the auditors of UK subsidiaries of US companies, particularly where these are not associates of the Big 4.

### **Interim solution: extend time for registration for overseas firms**

17. Both for the reasons of principle and of practicality therefore, we would strongly favour as an interim measure, a decision to allow more time to consider whether and/or in what circumstances there should be registration for foreign accounting firms, and also to explore practical solutions for making progress. We think that an extra year is needed to allow for this.

### **What regulation should there be for overseas accounting firms?**

18. We would be extremely concerned, were US requirements to be applied regardless of the regulatory regimes in other jurisdictions. The most obvious manifestations of a regulatory regime are the external monitoring of the firm and the application of an external investigation and disciplinary regime.

19. We cannot see that it is an attractive proposition even from a US perspective to try to apply a US monitoring or disciplinary regime to foreign audit firms, particularly where they are already subject to national requirements which are likely to be better suited to the job. Is it sensible, to take one example, for the PCAOB to try directly to monitor the quality of the work and compliance with the rules of a UK audit firm which carries out the statutory audit under UK requirements of a UK company which happens to be a significant subsidiary of a US registrant. It looks to be a recipe for an



inefficient and ineffective system. The idea of subjecting UK firms to a double dose of regulation is highly objectionable and could potentially lead to a proliferation of monitoring regimes from around the world applying to the same audit firm. There may be a temptation to impose such unwieldy arrangements also on US audit firms in some circumstances! If, alternatively, the proposal is to draw on the work of the UK regulatory authorities, then there would very clearly need to be negotiation and discussion; for example, on to what extent and how information collected for one purpose can be disclosed for another. Similarly imposing a US system of investigation and discipline on top of our own arrangements creates double jeopardy for firms and individuals.

20. We recognise that there is the closely related issue of access to audit working papers. We understand that this is important for you and that the SEC does not think that, where there are existing arrangements, these have worked well. This is a difficult area, complicated by the various provisions in the Sarbanes Oxley Act itself. It links quite closely to the legal difficulties surrounding the transfer of confidential information, for which in Europe there is considerable protection. In our view this needs further detailed negotiation, between the EU and the US, and/or between individual countries and the US. This might include exploring how existing arrangements can be made to work better.

21. As a very minimum we would expect the practical impact of US requirements to be minimal where there is already in place a regulatory regime which meets agreed principles or standards. Indeed we would very much hope that moves towards international standards, for example for auditing, will enable the US to remove its existing insistence on local US standards.



22. We hope that these comments are valuable as you develop your thinking. We look forward to developing our contact.

23. I am copying this letter to Dan Goelzer and to Ronald Boster.

Kind regards

Yours sincerely

JOHN GREWE

Director, Company Law, (Audit and Reporting)

## United Kingdom: Regulation of the Auditing and Accountancy Profession: A Brief Overview

1. The regulation of registered auditors in the United Kingdom is governed by the **Companies Act 1989**, which transposed the EU 8<sup>th</sup> Company Law Directive into the law. In brief this enables the Government to delegate regulatory powers to bodies which it recognises for this purpose where they meet a series of stringent requirements. Under this system there are five professional bodies which have delegated powers in respect of admission to the Register of Auditors and monitoring and discipline of registered auditors. These include the Institutes of Chartered Accountants in England and Wales, of Scotland and of Ireland, and the Association of Chartered Accountants. These bodies are accountable to the Department and to Parliament.
2. However, these arrangements do not tell the full story. There have been two major developments in the regulatory structure more recently – one starting in 1998 and one in 2002.
3. In 1998, the UK Government reached agreement with the six main UK accountancy bodies that the accountancy profession (NB not just the audit profession) should be subject to oversight through an independent but non-statutory body, the **Accountancy Foundation**, under which a number of boards were established, all with non practitioner majorities.
4. The boards under the Foundation were the **Auditing Practices Board** (which sets UK auditing standards); the **Ethics Standards Board** (which set the agenda for the professional bodies to bring forward standards for its approval); the **Investigations and Discipline Board** (which was to take responsibility for disciplinary cases of particular public interest, and a **Review Board**, which reviewed in particular the regulatory activities of the accountancy bodies. These activities included continuing responsibility for admission, monitoring and discipline of their members who are registered auditors.
5. More recently again, in 2002 the Government conducted a further review of the regulatory arrangements in the wake of US scandals such as Enron and WorldCom. This reported in January 2003 and the Government accepted all the principal recommendations, which are now being set in place.

6. The main further changes are:

(i) **The Financial Reporting Council (FRC)**, which already oversees the setting and enforcement of accounting standards; will take on the functions of the Accountancy Foundation. This will create an independent, unified and authoritative structure with clear areas of responsibility: the setting of accounting and audit standards; their enforcement; the monitoring and disciplining of the audits of public interest entities; and the oversight of the remaining regulatory responsibilities of the professional accountancy bodies.

(ii) The independent regulation and review of audit will be significantly strengthened. In particular, responsibility for setting **independence standards for auditors** should be transferred to the **Auditing Practices Board**, which will continue to have a 60% majority of non-practitioners .

(iii) A **new audit inspection unit** is being set up within the independent regulator to take over from the professional accountancy bodies responsibility for monitoring the audit of those entities whose activities have the greatest potential to impact on financial and economic stability – specifically listed companies and major charities and pensions funds.

(iv) a **Professional Oversight Board** will take over, as the successor to the Review Board, the oversight of those parts of audit and accountancy regulation which remain within the profession. This is also within the FRC structure. As a part of this, the Government's role in recognising professional supervisory bodies and qualifications for the purposes of the 8<sup>th</sup> Directive will be delegated to this Board. This Board will have a majority of non accountants.

(v) The planned new **Investigation and Discipline Scheme**, will be brought into being without delay by the Investigation and Discipline Board, within the FRC structure. The IDB has a lay majority. The new Scheme provides a demonstrably independent forum for hearing significant public interest disciplinary cases.

(vi) The annual running costs of the independent regulator should be broadly shared by Government, business and the professional bodies, with the exception of the costs of cases coming before the Investigation and Discipline Board, which will continue to fall to the professional

bodies, and the costs of the independent audit inspection unit, which should be borne by audit firms.

MARCH 2003