
BRIEFING PAPER

AUDITOR REGISTRATION SYSTEM

APRIL 23, 2003 PUBLIC MEETING OF THE BOARD

At its public meeting on April 23, 2003, the Public Company Accounting Oversight Board (“Board”) will consider whether to adopt, and submit for the approval of the Securities and Exchange Commission (the “Commission”), final rules relating to a registration system for public accounting firms, including non-U.S. firms.

Section 102 of the Sarbanes-Oxley Act of 2002 (the “Act”) prohibits accounting firms that are not registered with the Board from preparing or issuing audit reports on U.S. public companies (i.e., “issuers”, as defined in the Act) and from participating in such audits. Section 106(a) of the Act provides that any non-U.S. public accounting firm that prepares or furnishes an audit report with respect to any U.S. public company is subject to the Board’s rules to the same extent as a U.S. public accounting firm. Section 106(a) further authorizes the Board to require that non-U.S. public accounting firms that do not issue such reports, but that play a substantial role in the preparation of the audit reports, register.

The Act provides that firms must register with the Board if they wish to engage in these activities after the 180-day period following the Commission’s determination that the Board has the capacity to carry out the requirements of the Act. That determination must be made no later than April 26, 2003.

The registration system consists of eight rules (PCAOB Rules 2100 through 2106, and 2300), plus definitions that would appear in Rule 1001, and a form (PCAOB Form 1). In addition, the Board will consider whether to issue a release discussing the registration system and its general ramifications.

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Content of Rules and Forms

Appended to this paper are (1) a list of the titles of the registration rules, (2) an outline of the instructions to PCAOB Form 1 (Application for Registration as a Public Accounting Firm), and (3) a detailed summary of modifications and clarifications made to the rules and form as a result of the public comment process.

Set forth below are (1) an overview of the registration system, (2) highlights of certain modifications and clarifications made to the rules and form as originally proposed, and (3) a discussion of specific issues related to the registration of non-U.S. public accounting firms, including certain accommodations related to difficulties that may be posed by conflicts in non-U.S. laws, among other issues specific to non-U.S. firms:

Overview of the Registration System

- All public accounting firms, including both U.S. and non-U.S. firms, that wish to prepare or issue audit reports on U.S. public companies must register with the Board. In addition, any public accounting firm that “plays a substantial role in the preparation and furnishing of an audit report” (as defined in the Board’s rules) must register.
- While the definition of “public accounting firm” includes sole proprietorships, individual accountants that are associated with firms are not required to register. However, firms are required, as part of their registration application, to disclose the names of certain accountants associated with the firm who participate in or contribute to the preparation of audit reports of U.S. public companies.
- The Board will adopt instructions for its registration form (Form 1). However, the form itself will be Web-based and available only electronically.
- Form 1 consists of nine parts, subdivided into 22 items, requiring the disclosure of particular information concerning the applicant and its associated accountants and the applicant’s issuer clients. The information these items call for is generally required by Section 102(b) of the Act.

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- Applicants are also required to disclose in their applications any non-U.S. legal impediments that prevent them from furnishing information otherwise required by the application for registration.
- Applications for registration will be available to the public in accordance with Section 102(e) of the Act. Applicants may request confidential treatment of any portion of an application that contains non-public personal or proprietary information. The Board will decide whether to grant confidential treatment requests on a case-by-case basis.
- The Act requires applicants to pay a fee to cover the costs of processing and reviewing registration applications. The Board has yet to establish the level of the registration fee, but will do so in the near future. The Board will publicly announce the fee amount, and the payment procedure, before the registration system is operational. The Board contemplates that the amount of an applicant's fee will be determined by a formula and that registration fees will vary with the size of the applicant and the number of its issuer audit clients.
- Within 45 days of receipt of a completed registration application, the Board must (1) approve the application, (2) issue a written notice of a hearing, or (3) request more information from the prospective registrant. A written notice of a hearing will specify the proposed grounds for disapproval and may, at the applicant's election, be treated as a notice of disapproval that, under the Act, may be appealed to the Commission.
- The Board's registration system is expected to be ready to receive registration applications in late June or early July 2003. Public accounting firms, with the exception of non-U.S. firms, must be registered with the Board if they wish to engage in issuer audits after the end of the 180-day period following the Commission's determination that the Board has the capacity to carry out the requirements of the Act. This period will end approximately October 24, 2003. The Board's rules will afford non-U.S. firms one year within which to register (i.e., until approximately April 26, 2004). In light of the 45-day review period, U.S. firms' registration applications will have to be filed no later than early September (and non-U.S. firms' applications will have to

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be filed by, at the latest, early March 2004) to ensure Board action before the date after which firms must be registered. Because any requests by the Board for more information will restart the 45-day review period, the Board encourages firms to file their applications as soon as possible.

The Board also recommends that both U.S. and non-U.S. firms begin to compile the information necessary to complete Form 1 as soon as possible in order to meet their respective deadlines.

The Act requires that registered public accounting firms file annual reports with the Board, and authorizes the Board to require periodic updating of the information contained in a registered firm's registration application. The Board will consider rules and forms to implement these provisions of the Act at a later date. The Board will also in the near future consider rules and forms governing the amendment or withdrawal from registration after approval of a registration application.

Public Comment

The Board released its registration system proposal for public comment on March 7, 2003. The Board received more than 40 written comment letters relating to its proposal. In addition, on March 31, 2003, the Board convened a public roundtable at which representatives of various foreign accounting firms, professional organizations, and regulators, as well as U.S. investors, discussed the ramifications of the registration of non-U.S. accounting firms. In response to the written comments received and remarks made at the roundtable, the Board has clarified and modified certain aspects of its proposed rules and form on registration, to, among other things –

- Allow non-U.S. accounting firms one year (i.e., until approximately April 26, 2004) to register with the Board (Rule 2100);
- Allow an applicant to withhold information from its application for registration where disclosure of the information would cause the applicant to violate non-U.S. laws. An applicant claiming that submitting information would conflict with non-U.S. laws must identify the information the provision of which conflicts with non-U.S. laws, and include as an exhibit to Form 1, a copy of the relevant portion of the conflicting non-U.S. law and a legal opinion that

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submitting information would cause the applicant to violate the conflicting non-U.S. law. In addition, the exhibit must include an explanation of the applicant's efforts to seek consents and waivers, if the withheld information could be provided to the Board with a consent or a waiver, and a representation from the applicant as to its inability to obtain such consents or waivers (Rule 2105, General Instructions and Exhibit 99.2 to Form 1);

- Allow an applicant the opportunity for a hearing before the Board, if the Board is unable to determine that the standard for approval is met or determines that the application may be materially inaccurate or incomplete (Rule 2106);
- Clarify the timing of the public availability of applications for registration (i.e., that an application will be available to the public as soon as practicable after the Board approves or disapproves such application)(Rule 2300(a));
- Eliminate requirements to provide Social Security numbers, taxpayer identification numbers, and comparable non-U.S. tax identifiers (Rule 2300 and Form 1);
- Eliminate the requirement to provide additional financial information concerning the sources of the applicant's revenues (Form 1);
- Narrow the types of criminal, civil and administrative proceedings that are required to be disclosed, by –
 - (i) Limiting the required disclosure for criminal, civil, and administrative proceedings to only those involving the applicant or any associated person of the applicant (or, for foreign public accounting firms, the applicant or any such person who provides ten or more hours of audit services for an issuer) (Item 5.1, Form 1);
 - (ii) Limiting the required disclosure for criminal, civil, and administrative proceedings to those that are pending or were completed during the previous five years (Item 5.1, Form 1); and

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- (iii) Limiting the required disclosure for private civil actions involving conduct in connection with an audit report or comparable report to pending proceedings (Item 5.2, Form 1);
- Narrow the scope of the roster of associated accountants, for both U.S. and non-U.S firms, by
 - (i) Requiring disclosure for only those accountants who participate in or contribute to the preparation of audit reports for U.S. public companies (Item 7.1, Form 1);
 - (ii) Clarifying that applicants that are not foreign public accounting firms must list only “accountants” who are “persons associated with the applicant” and who provided at least ten hours of audit services for any issuer during the last calendar year (Item 7.1, Form 1); and
 - (iii) Clarifying that foreign public accounting firms must list only “accountants” who are a proprietor, partner, principal, shareholder, officer, or manager of the applicant and who provided at least ten hours of audit services for any issuer during the last calendar year (Item 7.1, Form 1); and
- Clarify the language to be used in the consents that the applicant is required to secure from its associated persons, specify that such consents must be secured no later than 45 days after the submission of the application, and provide that for foreign public accounting firms “associated persons” means the same group listed in the firm’s roster of associated accountants (Part VIII, Form 1).

Registration of Non-U.S. Public Accounting Firms

Section 106(a) of the Act provides, in part, that any non-U.S. public accounting firm that prepares or furnishes an audit report with respect to any U.S. public company is “subject to this Act and the rules of the Board and the Commission issued under this Act, in the same manner and to the same extent as a public accounting firm that is organized and operates under the laws of the United States or any State.” Under

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Section 106(c) of the Act, the Board and the Commission each have the authority to “exempt any foreign public accounting firm” from any provision of the Act as “necessary or appropriate in the public interest or for the protection of investors.” The Board received numerous comments in letters from public accounting firms, foreign governments and foreign professional accounting associations, requesting such exemptions from the Board’s registration requirements, as well as its inspections and disciplinary programs. Non-U.S. commenters also raised concerns that submitting the requested information would require them to violate non-U.S. laws, including laws intended to protect the privacy of individuals and the confidentiality of their clients. The Board also held a public roundtable meeting to discuss special issues raised by registration and oversight of non-U.S. firms. On the basis of the comments, the Board has afforded certain accommodations to address difficulties that may be posed by conflicts in non-U.S. laws and by differences in approaches and custom. Accordingly:

- Applicants (both U.S. and non-U.S.) will not be required to furnish, in the registration process, information, the disclosure of which would constitute a violation of non-U.S. law. These applicants would, however, be required to provide a copy of the relevant law (in English) and a legal opinion that the law would in fact prevent disclosure to the Board. Such applicants would also be required to provide an explanation of their efforts to seek consents or waivers to eliminate the conflict, if the withheld information could be provided to the Board with a consent or waiver, and a representation that they were unable to obtain such consents or waivers to eliminate the conflict. Thus, if an applicant has provided sufficient information on which to make the finding required for approval of a registration application, the absence of information prohibited by non-U.S. law will not make an application incomplete.
- The requirements to provide accountant names and license numbers (Part VII of the Form); consents to cooperate with Board inspections and investigations (Part VIII of the Form); and information about certain legal proceedings (Part V of the Form), as applied to non-U.S. firms, will include only partners and managers who participate in or contribute to the preparation of audit reports for U.S. issuers. In addition, as described above, disclosure requirements relating to criminal, civil and administrative proceedings have been narrowed for both U.S. and non-U.S. firms. If an applicant faces a legal impediment in agreeing to "secure and enforce . . . consents as a term and condition of

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employment," as mandated by the language of Section 102(b)(3)(A) of the Act, applicants would be required to provide a copy of the relevant law (in English) and a legal opinion that the law would in fact prevent the applicant from securing and enforcing consents. These modifications should accommodate privacy restrictions related to employment in certain non-U.S. jurisdictions and thus reduce the burden on non-U.S. firms in those jurisdictions to attempt to obtain consents to cooperate with Board requests for information and other personal information from employees below the manager level.

- Allow non-U.S. firms one year to register with the Board (or until approximately April 26, 2004).

The Board has determined, however, not to exempt from registration any public accounting firm that prepares or issues, or plays a substantial role in the preparation or issuance of, any audit report on financial statements that are filed in the United States. Registration is the predicate to all the Board's other oversight programs – compliance with auditing and other professional standards, inspections, and discipline – and therefore an exemption from registration would be tantamount to a complete exemption from any oversight by the Board.

We note however, the nature of the oversight to be exercised over registered foreign public accounting firms is a matter the Board has yet to resolve. In particular, the Board is concerned that non-U.S. oversight will necessarily focus on non-U.S. standards and requirements. The Board is aware that several countries have adopted or proposed corporate reforms that include new regulatory oversight of the auditing profession, and many countries have already adopted or planned programs to register, inspect and discipline accounting firms that prepare and issue audit reports for filing in those respective jurisdictions. The Board expects that the various reforms being considered in other jurisdictions will continue to improve the quality of audit reports prepared by firms worldwide. In this regard, the Board has already commenced dialogue with other oversight bodies outside the United States in order to achieve its objectives generally, as well as to try to find ways to reduce administrative burdens and to provide for coordination in areas where there is a common programmatic interest, such as annual reporting, inspection, and discipline.



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Adoption Procedure

If adopted by the Board, the proposed rules will be submitted to the Commission for approval. Pursuant to Section 107 of the Act, Board rules do not take effect until approved by the Commission.

* * * *

PCAOB is a private-sector, non-profit corporation, created by the Sarbanes-Oxley Act of 2002. Its mission is to protect investors in the U.S. markets and to further the public interest by ensuring that public company financial statements are audited according to the highest standards of quality, independence, and ethics. The Board will be principally funded by fees collected from public companies. The costs of processing and reviewing public accounting firm registration applications will be recovered from registration fees paid by those firms.

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APPENDIX

(1) List of Registration-Related Rules.

- Rule 1001 -- Definition of Terms Employed in Rules
- Rule 2100 -- Registration Requirements for Public Accounting Firms
- Rule 2101 -- Application for Registration
- Rule 2102 -- Date of Receipt
- Rule 2103 -- Registration Fee
- Rule 2104 -- Signatures
- Rule 2105 -- Conflicting Non-U.S. Laws
- Rule 2106 -- Action on Applications for Registration
- Rule 2300 -- Public Availability of Information Submitted to the Board; Confidential Treatment Requests

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(2) Outline of the Instructions to PCAOB Form 1 (Application for Registration as a Public Accounting Firm).

General Instructions

[There are ten general instructions to Form 1.]

Part I -- Identity of the Applicant

[This part contains seven items.]

Part II -- Listing of Applicant's Public Company Audit Clients and Related Fees

[This part contains four items.]

Part III -- [reserved]

Part IV -- Statement of Applicant's Quality Control Policies

[This part contains one item.]

Part V -- Listing of Certain Proceedings Involving the Applicant's Audit Practice

[This part contains three items.]

Part VI -- Listing of Filings Disclosing Accounting Disagreements With Public Company Audit Clients

[This part contains three items.]

Part VII -- Roster of Associated Accountants

[This part contains two items.]

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Part VIII -- Consents of Applicant

[This part contains one item.]

Part IX -- Signature of Applicant

[This part contains one item.]

Part X -- Exhibits

[This part contains seven exhibits.]

(3) Summary of Modifications and Clarifications to Rules and Form.

Rules

- Allow non-U.S. accounting firms one year (i.e., until approximately April 26, 2004) to register with the Board (Rule 2100);
- Permit certain accounting firms not to register with the Board, namely those firms that (i) have issued a consent to include or reissue an audit report for a prior period, but (ii) do not currently have and do not expect to have an audit engagement with an issuer, or to play a substantial role with respect to an issuer's audit after the effective date of the registration requirement (Rule 2100);
- Allow an applicant to withdraw an application for registration, prior to the Board approving or disapproving such application, by written notice to the Board (Rule 2101);
- Allow an applicant to withhold information from its application for registration where disclosure of the information would cause the applicant to violate non-U.S. laws. An applicant claiming that submitting information would conflict with non-U.S. laws must identify the information the provision of which conflicts with non-U.S. laws, and include as an exhibit to Form 1, a copy of the relevant portion of the conflicting non-U.S. law and a legal opinion that submitting information would

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cause the applicant to violate the conflicting non-U.S. law. In addition, the exhibit must include an explanation of the applicant's efforts to seek consents and waivers, if the withheld information could be provided to the Board with a consent or a waiver, and a representation from the applicant as to its inability to obtain such consents or waivers (Rule 2105, General Instructions and Exhibit 99.2 to Form 1);

- Allow an applicant the opportunity for a hearing before the Board, if the Board is unable to determine that the standard for approval is met or determines that the application may be materially inaccurate or incomplete (Rule 2106);
- Clarify that, if an applicant supplements its application with information requested by the Board, the Board will take action on such supplemented applications as soon as practicable, but not later than 45 days after the receipt of the supplemented application (Rule 2106(c));
- Clarify the timing of the public availability of applications for registration (i.e., that an application will be available to the public as soon as practicable after the Board approves or disapproves such application)(Rule 2300(a));
- Eliminate requirements to provide Social Security numbers, taxpayer identification numbers, and comparable non-U.S. tax identifiers (Rule 2300 and Form 1);
- Clarify that the Board will notify an applicant, to the extent permitted by law, in the event the Board receives a subpoena requesting information subject to confidential treatment by the Board (Rule 2300(g));
- Delegate authority to make determinations on confidential treatment requests (Rule 2300(h));
- Exclude persons engaged only in clerical or ministerial tasks from the definitions of both "accountant" and "associated person" (Rule 1001);

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- Clarify that the term “associated person of a public accounting firm” does not include a person that the applicant reasonably believes is an associated person of another registered or registering public accounting firm (Rule 1001);
- Clarify and modify the “substantial role” test by
 - (i) Modifying the second prong of the definition to include “to perform the majority of the audit procedures with respect to a subsidiary or component of any issuer the assets or revenues of which constitute 20% or more of the consolidated assets or revenues of such issuer necessary for the principal accountant to issue an audit report on the issuer;”
 - (ii) Specifying that the term “material services” does not include non-audit services provided to non-audit clients; and
 - (iii) Clarifying when the “20% or more of the consolidated assets or revenues” determination should be made;

Form

- Clarify the time frames for which non-historical (i.e., current) information should be provided (General Instructions to Form 1);
- Clarify that any information submitted as part of the form must be in English (General Instructions to Form 1);
- Eliminate the requirement to provide a representation that the applicant has all licenses and certifications required by governmental and professional organizations (Form 1);
- Clarify and modify certain disclosure requirements on audit client fees, by –
 - (i) Allowing applicants to provide estimated amounts to the extent such information has not been previously disclosed or is not known (Items 2.1 and 2.2, Form 1);

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- (ii) Clarifying when an applicant may presume that it is expected to prepare or issue an audit report (Item 2.3, Form 1);
- (iii) Limiting the requirement to disclose a list of issuers for which the applicant played or expects to play a substantial role in an audit by requiring this disclosure only of applicants that did not prepare or issue an audit report in the preceding or current calendar year and do not expect to prepare or issue an audit report during the calendar year (Item 2.4, Form 1);
- (iv) Modifying the disclosure categories for audit client fees to track those used in the auditor independence disclosure rules adopted by the Commission on November 15, 2000. Such disclosure requirement will be in effect until December 15, 2003, at which time the disclosure categories will track the Commission's recently revised auditor independence disclosure rules (Part II, Form 1); and
- (v) Eliminating requirements to provide an issuer's standard industry code (SIC) (Part II, Form 1);
- Eliminate the requirement to provide additional financial information concerning the sources of the applicant's revenues (Form 1);
- Narrow the types of criminal, civil and administrative proceedings that are required to be disclosed, by –
 - (i) Limiting the required disclosure for criminal, civil, and administrative proceedings to only those involving the applicant or any associated person of the applicant (or, for foreign public accounting firms, the applicant or any such person who provides ten or more hours of audit services for an issuer) (Item 5.1, Form 1);
 - (ii) Limiting the required disclosure for criminal, civil, and administrative proceedings to those that are pending or were completed during the previous five years (Item 5.1, Form 1); and

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- (iii) Limiting the required disclosure for private civil actions involving conduct in connection with an audit report or comparable report to pending proceedings (Item 5.2, Form 1);
- Narrow the scope of the roster of associated accountants, for both U.S. and non-U.S firms, by
 - (i) Requiring disclosure for only those accountants who participate in or contribute to the preparation of audit reports for U.S. public companies (Item 7.1, Form 1);
 - (ii) Clarifying that applicants that are not foreign public accounting firms must list only “accountants” who are “persons associated with the applicant” and who provided at least ten hours of audit services for any issuer during the last calendar year (Item 7.1, Form 1); and
 - (iii) Clarifying that foreign public accounting firms must list only “accountants” who are a proprietor, partner, principal, shareholder, officer, or manager of the applicant and who provided at least ten hours of audit services for any issuer during the last calendar year (Item 7.1, Form 1); and
- Clarify the language to be used in the consents that the applicant is required to secure from its associated persons, specify that such consents must be secured no later than 45 days after the submission of the application, and provide that for foreign public accounting firms “associated persons” means the same group listed in the firm’s roster of associated accountants (Part VIII, Form 1).