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Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

Re: PCAOB Rulemaking Docket Matter No. 013

Proposed Rules Relating To The Oversight Of Non-U.S. Public Accounting Firms

The member firms of Deloitte Touche Tohmatsu ("DTT") are pleased to respond to the request for comments from the Public Company Accounting Oversight Board (the "PCAOB" or the "Board") on its *Proposed Rules Relating to the Oversight of Non-U.S. Public Accounting Firms*, PCAOB Rulemaking Docket Matter No. 013 (Dec. 10, 2003) (the "Release" or the "Proposed Rules").

INTRODUCTION

We support the goals of the Sarbanes-Oxley Act of 2002 (the "Act") in restoring investor confidence as well as the Board's efforts to implement the Act faithfully, and we recognize and support the efforts of the Board to improve audit quality. The Act contemplates that the Board will have some regulatory authority over those non-U.S. public accounting firms that issue audit reports, or play a substantial role in the preparation of audit reports, for issuers of U.S. securities. Congress recognized, however, that the direct regulation of non-U.S. public accounting firms by a U.S. body could raise delicate legal and practical issues and may be redundant of the public accounting regulatory systems of other countries.[1] Congress thus intended that the Board proceed with caution before it imposed its regulatory regime over that provided by the home countries of non-U.S. public accounting firms.

We, therefore, support the Board's efforts, throughout its rulemaking and otherwise, to forge cooperation between the non-U.S. regulators of the public accounting profession and the Board. We also support other aspects of the Board's proposal. Specifically, we applaud the Board's proposal to grant a three-month extension for the registration deadline of non.-U.S.

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[1] *See* Act § 106(c) (granting the Securities and Exchange Commission and the Board authority to exempt non-U.S. public accounting firms from any provision of the Act or the rules of the Board or the Commission issued under the Act).

firms, which, among other things, will allow the Board and non-U.S. regulators additional time to engage in a cooperative dialogue regarding oversight of non-U.S. firms.

Fundamentally, however, we believe that the Board has erred by placing the onus on non-U.S. public accounting firms to demonstrate the adequacy of their home regulator's oversight system. Instead, we believe that such matters are more appropriately the subject of international conventions among the Board and non-U.S. regulators. Through such a process, the Board may establish or strengthen its cooperative ties with non-U.S. regulators, while ensuring that the non-U.S. regulators meet reasonable standards of rigor in the enforcement of their oversight systems.

If the Board were to retain its current proposal for evaluating the qualifications of home country regulators, the Board should make critical modifications to the proposal. In particular, the Board should: (1) specify the procedures under which the Board will consider a request for reliance by a non-U.S. public accounting firm; (2) modify some of its criteria for determining whether a non-U.S. regulatory system is sufficiently rigorous and independent to merit reliance; (3) establish procedures for changing a reliance determination; and (4) strengthen the effect of its reliance determination on the Board's decisions to institute an inspection or investigation.[2]

I. THE BOARD SHOULD NOT REQUIRE SUBMISSIONS BY INDIVIDUAL FIRMS UNDER PROPOSED RULE 4011 AND SHOULD INSTEAD REACH RELIANCE AGREEMENTS WITH NON-U.S. REGULATORS THROUGH INTERNATIONAL CONVENTIONS.

We agree with the Board that its oversight of non-U.S. public accounting firms raises "special concerns" and that the best way to address these concerns is through a "cooperative arrangement" with non-U.S. regulators of the accounting profession.[3] Specifically, we concur with the Board that it should "seek[] to become partners" with non-U.S. regulators in their common enterprise to enhance audit quality and to protect the global capital markets from potential corporate reporting failures.[4]

The Release proposes that the Board determine the extent to which it will rely on each country's regulator through requests *by individual non-U.S. public accounting firms*. In doing so, the Release proposes an indirect, rather than a direct, way to accomplish these goals of cooperation between the Board and non-U.S. regulators. We believe that cooperation would be advanced in a more timely, efficient, and effective manner if the Board and non-U.S. regulators were to determine the extent of mutual recognition through direct negotiations and discussions. These negotiations and discussions could be facilitated through the involvement of an existing international organization, such as the International Organization of Securities Commissions

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[2] As we note below, many of our suggestions in these four areas would also be important in any system of agreements with non-U.S. regulators that the Board might develop.

[3] Release at 3.

[4] *Id. See also Briefing Paper: Oversight of Non-U.S. Public Accounting Firms*, PCAOB Release No. 2003-020, at 1 (Oct. 28, 2003) ("Briefing Paper").

("IOSCO"), or an international body established for the specific purpose of determining the extent of mutual recognition among regulators.

Under the auspices of such an organization, the Board and its non-U.S. counterparts may discuss and agree upon the fundamental features of an independent and rigorous system for regulating the public accounting profession that will guide the extent to which regulators may be mutually recognized.[5] If these principles for independent and rigorous regulation were developed through consensus, as opposed to being asserted by the Board alone, the Board would be significantly more likely to succeed in encouraging other countries to make legislative modifications that improve the oversight of the public accounting profession. Because the criteria for mutual recognition, if reached through international conventions, would be perceived to be more objective, non-U.S. regulators also would be more likely to participate in the system of cooperation and information-sharing that lies at the heart of the Board's proposal to rely on the oversight of non-U.S. regulators when consistent with the requirements of the Act. Concerns about sovereignty and extra-territorial imposition of U.S. law would also be alleviated if these reliance determinations were made through regulator-to-regulator negotiations.

Such a process would yield especially significant benefits given that significant revisions of several non-U.S. regulatory systems are in their nascent stages. For example, the European Union ("EU") is currently developing a revised Eighth Directive, which would establish minimum auditing standards for the public accounting oversight bodies of EU member countries, and would require the registration of audit firms. It is of particular importance for developing cooperative arrangements that the proposed Eighth Directive would establish procedures for cooperation among EU member state regulators on investigations of public accounting firms.[6] If the Board were to seek a mutual recognition agreement with the EU directly, as opposed to making reliance determinations through firm-by-firm submissions, the Board may be able to participate in the development of these cooperation procedures. Indeed, the EU has contemplated developing precisely such a "cooperative working model with the U.S. Public Company Accounting Oversight Board" during the course of revising the Eighth Directive.[7]

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[5] For example, the Board and non-U.S. regulators could determine the extent to which mutual recognition is appropriate in light of the familiarity of one regulator with another country's set of accounting and auditing standards.

[6] European Union Press Release, *Preparation of Eurogroup and Council of Economics and Finance Ministers, Brussels, 19th 20th January 2004*, at 3 (Jan. 19, 2004) (stating that the Revised Eighth Directive will "tighten the oversight of auditors, will establish rules on quality assurance, will specify the rules on independence and on ethics, and will impose the use of high quality auditing standards for all statutory audits," in addition to "enhanc[ing] cooperation over oversight bodies at [the] European level").

[7] *Id. See also* European Union Press Release, *Results of Council of Economics and Finance Ministers, Brussels, 20th January 2004, Financial Services and Taxation*, at 1 (Jan. 21, 2004) (stating that the revision of the Eighth Directive would "enhance cooperation of oversight bodies at European level and with third country regulators").

Similarly, there is pending legislation in Australia that proposes to establish a new Audit Independence Supervisory Board, in addition to the Australia Securities and Investment Corporation, which would have a majority of non-accountant members.[8] If the Board were to develop consensus agreements on mutual recognition, the Board could significantly shape the early rulemaking of these evolving non-U.S. regulatory bodies in a manner that could assist the Board in fulfilling its statutory obligations.

A direct negotiation process through an international organization would also ease current difficulties in the implementation of the Board's rules. As the Board recognizes in the Release, the imposition of its oversight system on non-U.S. public accounting firms will inevitably raise conflicts with non-U.S. law.[9] Data privacy laws, professional obligations under non-U.S. laws and professional standards, and laws specific to a particular client's business in non-U.S. jurisdictions may hinder or prevent inspections or investigations of non-U.S. firms that are registered with the Board.[10] For example, the review and processing of personal data in member countries of the European Union is often governed by national laws implementing European Directive 95/46/EC of October 24, 1995. These national laws impose certain prohibitions on the entity processing personal data, including the extent to which the entity is permitted to disclose the personal data to third parties. Processing may include the collection, retrieval, distribution and transfer to other countries of personal data.

Similarly, duties of confidentiality under both non-U.S. laws and professional standards in many countries may well restrict the ability of non-U.S. firms to provide the Board access during inspections and investigations. While client waivers can in some countries address these impediments, in other countries the restrictions are absolute and client waivers would not serve to eliminate the impediment. Moreover, the ability of audit firms in certain countries to provide access to audit workpapers is further restricted by impediments that arise from the nature of the client's business. For example, where an audit firm serves a client involved in the banking industry or the government contracting industry, the firm's ability to provide access to workpapers may be more severely restricted by banking secrecy laws and national security laws.

Making mutual recognition determinations through negotiations with non-U.S. regulators could resolve some of these conflicts as the regulators agree to relax the rules that are creating the conflict or to determine other means for resolving the conflict. In addition, our proposal

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[8] *CLERP 9, 2002* (Cth) s. 2.5.1 (Austl.). Other countries also have rigorous public accounting regulatory systems in place, including, for example, Denmark, France, Japan, Spain, Sweden, and the United Kingdom.

[9] Release at 4.

[10] We have previously highlighted these legal impediment issues by contributing to Deloitte & Touche LLP's March 31, 2003 comment letter to the Board regarding the Board's proposed registration system and Deloitte & Touche LLP's January 20, 2004 comment letter regarding the Board's audit documentation rules.

would alleviate difficulties with compound or duplicate sanctions in multiple enforcement proceedings.[11]

The burdens on the Board would also be greatly reduced. The Release's proposed firm-by-firm request system promises to present the Board with a significant amount of data to process and with highly particularized determinations to make. Moreover, the Board contemplates that its reliance determinations would be revised, and additional requests received, on the basis of any of a number of changes in the regulatory regimes of foreign countries. By resolving such issues through agreements with the regulators themselves, the Board may achieve certain assurances of oversight activities and not be charged with such an extensive monitoring process. Moreover, the Board would not be deluged with reliance requests from each individual non-U.S. public accounting firm. Instead, direct negotiation with a single non-U.S. regulator would at once resolve reliance issues pertaining to many non-U.S. public accounting firms.

Finally, determining the proper extent of reliance on the oversight for non-U.S. regulators through international conventions could lead to *mutual* recognition. Through mutual recognition, non-U.S. regulators may agree to rely on the Board for the oversight of U.S. public accounting firms.[12] The Board's proposed system of unilaterally determining the degree of reliance would not be likely to yield this significant benefit. Mutual recognition would not just be an advantage for U.S. public accounting firms. As the Board itself has recognized, "allowing oversight regimes to allocate their resources in the most cost effective manner" is an important objective.[13] By eliminating redundancies in the global oversight of public accounting firms and by allowing non-U.S. regulators to focus on their own domestic public accounting firms, with which they have a special expertise, mutual recognition would advance the Board's goal of eliminating corporate reporting failures from the global capital markets.

By reaching mutual recognition determinations through direct consultation with non-U.S. regulators, the Board would enhance the cooperation with non-U.S. regulators, would be better able to influence legislative change abroad, would facilitate the elimination of conflicts with non-

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[11] Briefing Paper at 4.

[12] Mutual recognition also could lead to a system where registration with a home country regulator is effectively the equivalent of registration with the Board. Rather than embracing such a system, the Release suggests that the Board's rules allow for the possibility that a non-U.S. firm could register with the Board by submitting the registration application to the home country regulator. *See* Release at 6. But, given that the Release then states the home country regulator must transmit the application to the Board, it is unclear what practical benefit, if any, this proposal would engender. In addition, as discussed in Section II.B. below, the Board should consider whether it has the statutory authority to assist non-U.S. regulators in either their inspections or investigations of U.S. firms and, to the extent the Board does have such authority, the terms under which the Board may share its own information with non-U.S. regulators.

[13] Briefing Paper at 1.

U.S. law that arise in the implementation of the Board's rules, and would be more likely to obtain the reciprocal benefit of the non-U.S. regulator's reliance on the Board for U.S. public accounting firms.

II. IF THE BOARD WERE TO UNDERTAKE RELIANCE DETERMINATIONS ON ITS OWN INITIATIVE, THE BOARD SHOULD MAKE SEVERAL MODIFICATIONS TO ITS PROPOSAL

A. THE PROCESS FOR RELIANCE REQUESTS IS CUMBERSOME AND NEEDS CLARIFICATION.

As discussed above, we believe that the Board should replace its firm-by-firm submission system and, instead, make its reliance determinations through international conventions with non-U.S. regulators. If the Board were to choose to make reliance determinations outside of an agreed-upon international framework, the Board must modify its proposal to provide an orderly, reliable, and transparent process for those determinations. It is important to bear in mind when considering the proposed modifications below that they could also apply within a system of mutual recognition agreements with non-U.S. regulators that, we argue, the Board should adopt in place of its current proposal.

First, home country regulators—at the prompting of a non-U.S. firm—should be the parties responsible for providing the information necessary for a reliance request to the Board. If non-U.S. firms are required to characterize their domestic oversight systems, they risk embarrassment, rebuke, and delay from home country regulators for statements with which the regulator may not agree—for any of a number of certainly legitimate reasons. In addition, the Board is likely to receive more complete and accurate information if the submitted information constitutes the authoritative representations of the non-U.S. regulator itself, as opposed to the potentially disparate descriptions of the non-U.S. regulator submitted by two or more individual firms in a particular country.

Second, the Board should provide some timeframe within which it must make a reliance determination. In the Release, the Board encourages non-U.S. public accounting firms to petition the Board for a reliance determination "as soon as practicable after the approval of their registration application."[14] Nevertheless, the Release contains no indication of the time within which the Board will make a reliance determination or of the scope of its inspections while a request for reliance is pending. Without specification, the Board may embark on inspecting a non-U.S. registered firm as if it were a U.S. registered firm, even though a request for reliance may be indefinitely pending. Accordingly, we recommend that the Board make clear that reliance determinations will ordinarily be made within ninety days of a reliance request. In addition, the Board should state that full reliance will be the default presumption until the Board makes an affirmative decision to accord a foreign regulator less than full reliance.

Third, the Board should make its decisionmaking process in response to a reliance request more transparent. The current proposal does not require that the Board issue a written

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[14] Release at 9 n.12.

reliance decision and provides no hearing for the petitioning entity in the event of an adverse decision. Both a written decision explaining the reasons for a particular reliance action and a hearing are necessary to ensure that the Board is engaging in a reasoned and fair decisionmaking process. The proposal also states that the Board will conduct "discussions" with non-U.S. regulators regarding a reliance request.[15] The proposal, however, does not expressly contemplate that affected non-U.S. firms will be able to participate in those discussions. At a minimum, the Board should make available to affected non-U.S. firms any written correspondence on a reliance issue between the Board and non-U.S. regulators so that such firms may respond to issues raised in the Board's discussions.[16]

B. THE CRITERIA FOR MAKING RELIANCE DETERMINATIONS SHOULD BE MODIFIED

The Board has set forth "principles" for evaluating whether reliance on a non-U.S. regulator is appropriate. While the Board's principles reflect a possible method for structuring an independent and rigorous oversight system for a country's accountants, we are concerned that the Board's "principles" ignore other adequate methods of regulation. Specifically, the Board should be careful not to demand that foreign governments adopt exactly the Board's model in order to qualify for reliance. As the Board itself has stated, its rules should seek to "accommodate the variety of inspection systems found around the world."[17] In recognition that there are other legitimate methods for ensuring robust oversight of a country's accounting firms, we believe that the Board should modify its "principles" for making reliance determinations.

First, the Board should not place unduly heavy weight on whether a majority of a non-U.S. regulator's members are not licensed accountants. The Release states that the Board will inquire as to whether "a majority of the individuals with whom the system's decisionmaking authority resides does not hold licenses or certifications authorizing them to engage in the business of auditing or accounting and did not hold such licenses for at least the last five years immediately before assuming their position within the system."[18] Before the Act, however, the U.S. system of accounting regulation through state regulatory bodies, in many instances, lacked any such disqualification of licensed accountants. Non-U.S. regulators cannot be faulted for having in place what, until 2002, was the U.S. model for regulating the accounting industry.

Although Congress decided that only two out of the five PCAOB members must be licensed accountants,[19] there are other valid methods for ensuring independence. For example,

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[15] Release at 9.

[16] In the course of this process, the firms could also provide the non-U.S. regulator with suggestions for improvement in light of the Board's oversight responsibilities.

[17] Briefing Paper at 2.

[18] Release at 11.

[19] Act § 101(e)(2).

foreign governments may have focused on ensuring that their oversight bodies had extensive expertise through permitting greater proportions of licensed accountants to sit on those oversight bodies, while still ensuring independence through strong conflict of interest rules. The mere fact that Congress chose a particular system to ensure the independence of the Board does not suggest that alternatives are illegitimate or inadequate or would somehow subject non-U.S. regulators to improper influence.

Second, the Board should not hold against a non-U.S. regulator an inability to provide all of its investigatory and regulatory information to the Board. The Release states that, in determining the degree of reliance on the non-U.S. regulator, the "Board would give great weight to the non-U.S. inspecting entity's willingness to agree to provide the Board or its staff, upon their request, the inspecting entity's workpapers or work product that document any inspection, evaluation or testing, and to provide the Board, in a form and with a level of detail agreed upon with the PCAOB, a report relating to any inspection, evaluation or testing."[20] As discussed previously, the legal regimes in many countries may make it impossible for the non-U.S. regulator to disclose some regulatory, investigatory, or inspection information to the Board. Indeed, the Board itself appears to lack the authority to disclose information gathered during an inspection and underlying an inspection report or other types of investigatory information to foreign regulators. Section 105(b)(5)(A) strictly prohibits the disclosure of inspection and investigatory information by the Board, renders that information privileged against legal discovery, and insulates that information from the operation of various freedom of information and public records acts. Notwithstanding this strong confidentiality provision, the Board is permitted to disclose such information to a carefully limited set of domestic law enforcement entities—the Attorney General of the United States, the "appropriate Federal functional regulator," state attorneys general, and "appropriate State regulatory authorit[ies]."[21] Regulators in non-U.S. jurisdictions are not, however, among the exceptions to the Act's confidentiality requirement. The Board should not penalize a non-U.S. regulator for an inability to do that which the Board is statutorily prohibited to do.[22]

Third, the Board should adopt more detailed principles for use in determining whether reliance can be placed on a non-U.S. regulator in the context of an investigation. The Release suggests that the Board's reliance determination for an investigation will be based on the "circumstances at hand," "the independence and rigor of the non-U.S. regulatory authority," and

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[20] Release at 13.

[21] Act § 105(b)(5)(B).

[22] On a related matter, the Board should specifically state that any information that it does receive through an arrangement with a non-U.S. regulator will be held confidentially by the Board. The same justifications for the statutory guarantee of confidentiality with regard to the Board's own investigatory information—including the protection of investigated public accounting firms and associated persons—would apply to similar investigatory information gathered by non-U.S. regulators. *See* Briefing Paper at 3.

the "non-U.S. authority's willingness to share information."[23] These broad statements provide insufficient guidance on the type of materials that should be submitted to the Board in support of a reliance request. We therefore urge that the final rule or accompanying release include additional detail regarding the principles that will be used in making reliance determinations for investigations. In addition, to bring some transparency to the process, we recommend that, as is the case with the reliance determinations for inspections, the extent to which the Board may place reliance on a non-U.S. regulator should be determined on a periodic basis for each non-U.S. jurisdiction that has made a reliance request, rather than on an *ad hoc* basis for each investigated non-U.S. firm.

C. THE STANDARD FOR CHANGING A RELIANCE DETERMINATION SHOULD BE CLARIFIED

The Board should also establish procedures and standards for any potential changes in a reliance determination that has already been made. The Release would require that non-U.S. firms renew their applications for reliance on non-U.S. regulators annually. This approach is unduly burdensome, inefficient, and should be unnecessary if the Board, in fact, establishes a cooperative relationship with the relevant non-U.S. regulator.

Instead, the Board should make clear that a reliance determination will remain in effect until a formal request is made to change the determination or the Board has notified the non-U.S. regulator and the affected firms of its intent to change the determination and all affected firms have an opportunity to submit comments on the proposed change. Such a modification will permit the Board to make fully informed reliance determinations without upsetting the legitimate expectations of regulated firms.

D. THE EFFECT OF THE RELIANCE DETERMINATION SHOULD BE STRENGTHENED

Although the Board's proposal embodies a system for making reliance determinations, the Release states that the Board may depart from an established reliance determination and perform its own inspection or investigation at any time.[24] We believe that the Board's reservation of this unfettered discretion is inconsistent with its commitment to cooperate with non-U.S. regulators. Indeed, the Board's statement that it may depart from a reliance determination at any time provides little incentive for non-U.S. firms and their home country regulators to undertake the extensive burdens necessary to seek a reliance determination from the Board.

At the same time, we recognize that circumstances may arise in which the Board may need to conduct its own investigation or inspection notwithstanding its prior reliance determination. Even if providing for such a possibility is necessary, the Board should at least establish standards and procedures that foster cooperation between the Board and non-U.S.

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[23] Release at 14.

[24] Release at 14.

regulators. The final rules, at a minimum, should specifically state that, once an appropriate level of reliance has been determined for a non-U.S. regulator, the Board will abide by that determination until the non-U.S. regulator demonstrably fails effectively to regulate its home country public accounting firms. To implement this standard, the Board's rules should establish a procedure under which a non-U.S. regulator is formally notified of the Board's concern and is guaranteed a minimum period of time in which to respond to the Board. Only after that period has passed, and the non-U.S. regulator has failed to offer an adequate response to the Board's concerns, should the Board be able to initiate its own inspection or investigation. Placing such procedures in the Board's rule would somewhat assure non-U.S. regulators that the Board is serious about cooperation and that it will not immediately trample on any cooperative arrangement in the event of a high profile issue in need of regulatory attention.

Moreover, the proposal contemplates that, for even those non-U.S. regulators accorded the highest levels of reliance by the Board, inspections of a registered non-U.S. firm would occur with the participation of Board-designated experts or other agents of the Board.[25] We are concerned that the Board does not appreciate the magnitude of the undertaking that such participation by Board experts or other agents would require. Just considering the affiliate non-U.S. firms of large U.S. public accounting firms, the Board's experts and other agents would be charged with attending hundreds of inspections under the proposed system. Because of various non-U.S. confidentiality laws discussed above, Board experts or other agents may not even have full access to the audit workpapers that are the subject of the audit. The Board's staff would then be required to execute its own, duplicate inspection report concerning the work of the non-U.S. regulator and accompanying Board experts or other agents.[26] We believe that global oversight resources would be much better allocated if the Board eliminated the requirement for Board agent participation in inspection by non-U.S. regulators, at least for those regulators afforded higher levels of reliance.

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[25] Release at 13.

[26] Release at 13-14.

CONCLUSION

We applaud the Board's efforts, in this Release and elsewhere, to establish a cooperative relationship with non-U.S. regulators and to eliminate redundancies in the Board and non-U.S. regulators' common oversight of non-U.S. public accounting firms that issue audit reports, or play a substantial role in the audit reports, of U.S. issuers. We believe, however, that there are more effective and efficient methods for the Board to accomplish those objectives while ensuring that its mandate to oversee public accounting firms is fulfilled. Accordingly, we ask that the Board adopt the suggestions outlined above. If you have any questions or would like to discuss these issues further, please contact P. Nicholas Fraser at (212) 492-4118.

Very truly yours,

/s/ Deloitte Touche Tohmatsu

cc: William J. McDonough, Chairman of the Board
Kayla J. Gillan, Board Member
Daniel L. Goelzer, Board Member
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