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J. Gordon Seymour
Acting Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

**PCAOB Rulemaking Docket Matter No. 013,
Proposed Rules Relating to the Oversight of
Non-U.S. Public Accounting Firms**

Dear Mr. Seymour:

Ernst & Young LLP ("Ernst & Young"), a U.S. registered public accounting firm, is pleased to submit comments on the proposal of the Public Company Accounting Oversight Board ("PCAOB" or "the Board") relating to the oversight of non-U.S. public accounting firms. Ernst & Young's affiliated firms located in foreign countries have provided assistance in the preparation of this letter.

We believe that the proposal reflects the Board's strong commitment to work cooperatively with non-U.S. regulators in order to achieve important objectives, such as improving audit quality and helping to restore public trust in the auditing profession. Ernst & Young shares those objectives, and we believe that international cooperation is the best means of achieving those goals. Moreover, we believe that these goals can best be achieved when the regulatory requirements are as clear as possible, and we are therefore seeking guidance with respect to certain international issues.

We have the following specific comments on the proposal:

1. The Release states at page 6: "Existing PCAOB Rule 2101 allows for the possibility that a non-U.S. firm could register with the PCAOB by submitting the required application via its home country registration entity, if required by that entity, which then would submit it to the PCAOB." We fully support the concept that foreign firms would be allowed to register with the PCAOB by submitting an application through the relevant foreign regulator. There is, however, some uncertainty about how the PCAOB intends to implement this option. This is because, contrary to the statement on page 6 of the Release, existing Rule 2101 does not provide for the possibility of home country registration, so this statement appears to be incorrect.[1] We strongly urge the Board to

[1] Existing PCAOB Rule 2101 states in its entirety: "Any public accounting firm applying to the Board for registration pursuant to Rule 2100 must complete and file an application for registration on Form 1 by following the

amend Rule 2101 so that it is consistent with the Release's description of that rule quoted above.

Allowing the filing of a registration form with local regulators rather than with the PCAOB would help accomplish the important objectives outlined in the PCAOB's Release and in its recent Briefing Paper on Oversight of Non-U.S. Public Accounting Firms (PCAOB Release No. 2003-020, October 28, 2003) ("Briefing Paper"). In those documents, the PCAOB states that it "seeks to become partners with its non-U.S. counterparts in the oversight of the audit firms that operate in the global capital markets." Release at 3; Briefing Paper at 1. Further, the Board has emphasized the establishment of "an efficient and effective cooperative arrangement" with foreign regulators. *Id.*

This goal of "partnership" and "cooperation" with foreign regulators could be significantly advanced if non-U.S. accounting firms were permitted to file their PCAOB registration applications with their local regulators. Such a procedure could provide the building block for other aspects of cooperative relationships, including those with respect to inspections and investigations.

With these goals in mind, if the PCAOB were to amend Rule 2101 to be consistent with the description in this Release, the Board might appropriately state that a non-U.S. firm could register with its home country if home country registration is "permitted" by the local regulator, rather than "required" by the local regulator as stated in the Release at page 6. Such a change would provide greater flexibility and would further advance the goals of international regulatory cooperation. We also suggest that, if the Board were to permit home country registration, it should provide foreign regulators with some substantive and meaningful role in the registration process. For example, the foreign regulator should be encouraged to advise the Board on the impact of foreign confidentiality and other laws on certain registration form disclosure requirements and to work with relevant accounting firms in addressing these issues. Furthermore, the Board could determine the extent to which compliance by a non-U.S. firm with the local registration requirements, both in terms of content and form, might be deemed to satisfy all or part of the Board's own registration requirements.

2. The Board proposes a "sliding scale" with respect to reliance on the work of oversight systems in non-U.S. jurisdictions. Release at 8. Under this approach, the Board would more readily defer to regulatory regimes that provide oversight of accounting firms in a manner similar to that provided by the Board than to those that do not exercise such oversight. As to the latter, the Board itself would perform inspections and investigations of registered accounting firms in the relevant jurisdictions.

This proposal does not seem to take into consideration international law conflicts. There are jurisdictions outside of the United States that, absent some agreement with or

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instructions to that form. Unless directed otherwise by the Board, the applicant must file such application and exhibits thereto electronically with the Board through the Board's web-based registration system. An applicant may withdraw its application for registration by written notice to the Board at any time before the approval or disapproval of the application."

cooperation from local authorities, would prohibit or restrict U.S. regulators from entering the local jurisdiction in order to inspect or investigate local entities or persons. Accordingly, no matter how a particular jurisdiction fares on the sliding scale, the PCAOB should take the approach of working cooperatively with local regulators with respect to any inspection or investigation of a registered accounting firm in a non-U.S. jurisdiction.

In this regard, the "sliding scale" approach is not altogether consistent with the PCAOB's stated goals of cooperation and partnership with foreign regulators. There may be foreign regulators that would fare poorly on the factors that comprise the proposed sliding scale but that would nonetheless be willing and able to work with the PCAOB and assist it in the performance of inspections and investigations. That willingness to cooperate in the global regulation of accounting firms seems far more important as a factor in guiding the PCAOB's handling of foreign inspections and investigations than do the elements of the proposed sliding scale (such as whether the foreign regulators are appointed by the relevant government, whether the foreign regulators hold accounting licenses, and so on).

3. Proposed Rule 4011 would permit a foreign registered accounting firm to submit a written petition requesting that the Board rely upon inspections conducted by a home country system. The petition would describe in detail the non-U.S. system's laws, rules, and other information to assist the Board in evaluating the system's independence and rigor.

   We support this element of the proposal. We expect that many of our non-U.S. affiliates will work with other accounting firms in the relevant jurisdiction, and with local regulators, in developing such a petition. That process will, by itself, likely lead to a healthy examination of the local regulatory regime and could result in its strengthening.

   We do suggest, however, that foreign firms and regulators be permitted an alternative approach, whereby the regulator – rather than, or in addition to, the accounting firms – be permitted to submit a petition. This is because the proposed rule essentially requires a foreign accounting firm to evaluate and to describe the effectiveness of its own regulator. In some jurisdictions, this may be an awkward process, and allowing a regulator-filed petition as an alternative seems advisable.

4. We agree with certain elements of the sliding scale. For instance, it seems important that the foreign regulator be independent of the accounting profession and have an independent source of funding. We do not, however, agree with other elements of the sliding scale. In particular, the scale places emphasis on whether the regulators are non-accountants – *see, e.g.*, page 11 of the Release: "whether a majority of the individuals with whom the system's decision-making 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." We acknowledge that Congress, in Section 101(e) of the Sarbanes-Oxley Act, required that the PCAOB consist of a majority of non-accountants, but we submit that this decision largely reflects the unusual time and

circumstances that gave rise to the Act's passage. In any event, we do not think that a U.S. value judgment on this issue should be extended to foreign regulators.

5. The Board states (Release at 15) that it will assist foreign regulators by inspecting or investigating U.S. firms that audit or play a substantial role in the audits of "public companies in non-U.S. jurisdictions." This commitment is apparently meant to encompass a situation where the company as to which the U.S. firm "audits or plays a substantial role" is not itself an SEC registrant. *Id*. The Release further states that additional rulemaking is "not necessary to carry out the Board's authority in this area." Release at 15 n.13. Although we believe that such assistance to foreign regulators would be consistent with the international cooperation goals outlined in the release, we query whether the Board does have the statutory authority to conduct such inspections or investigations. The Board's statutory authority relates to issuers, which would not include non-U.S. public companies that do not meet the definition of "issuers" under the Act.

   In this regard, if the Board believes it has the authority to assist foreign regulators in its inspection or investigation of registered accounting firms with respect to non-issuers, then it follows that the Board also has the authority to inspect or investigate registered firms generally as to their audit work on non-issuers. Such an assumption of authority would significantly expand the Board's powers beyond its statutory authorization.

   In addition, to the extent the Board intends to assist foreign regulators in their investigations, we note the importance of the strict provisions of the Sarbanes-Oxley Act (see Section 105(b)(5)) relating to confidentiality, discoverability, and use of information that the PCAOB receives from registered accounting firms. These protections would not automatically apply if the PCAOB were to share materials with foreign regulators. As the PCAOB develops cooperative relationships with foreign regulators, which we strongly support, we urge the Board to ensure that the confidentiality of information that is shared with the PCAOB's foreign counterparts be protected to the same extent as set forth in the Act.

6. Proposed Rule 5113 states that the Board may, in appropriate circumstances, "rely upon" the investigation of a registered accounting firm and sanctions imposed upon that firm by a foreign regulator. Release at 14. It is not clear from the Release, however, what the Board means by the phrase "rely upon" in this context. If the Board is suggesting that it will use the results of a foreign regulator's investigation, including a finding of violation, as the basis for the Board's own disciplinary proceeding against the relevant foreign firm, we respectfully disagree.

   Under Section 105(c)(4) of the Sarbanes-Oxley Act, the PCAOB may only impose sanctions based on a violation of "this Act, the rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission issued under this Act, or professional standards." The PCAOB does not have authority to impose sanctions on registered accounting firm based on violation of non-U.S. laws. (By contrast, the SEC sought and obtained explicit statutory authority to

impose sanctions on foreign securities professionals, such as broker-dealers, based on a foreign court or foreign regulator's finding of violation of certain foreign laws. *See* International Securities Enforcement Cooperation Act of 1990, Pub. L. No. 101-550, § 203(a), 104 Stat. 2714 (1990) (codified as amended at Section 15(b) of the Exchange Act)). Accordingly, the proposed rule might properly be amended so that it states merely that the PCAOB might rely upon "the assistance" of a foreign regulator in performing its own investigations.

7. The Board has proposed a three-month extension of time for the registration of non-U.S. accounting firms. We support this proposed extension. In this regard, we are taking the opportunity of this comment letter to bring the Board up-to-date on some of the non-U.S. registration-related issues that the U.S. firms have been dealing with thus far. We are doing so in part with the expectation that the Board might provide greater transparency and guidance with respect to certain matters.

U.S. accounting firms were required to be registered with the Board no later than October 22, 2003. One of the requirements was that registering firms were required to obtain consents to cooperate from "associated persons" of the registering firm.

Although not stated in the rulemaking releases or public meeting on this matter, the Board's staff informally advised accounting firm representatives that such consents were required from non-U.S. accounting firms that have any involvement in the U.S. firm's audit of a public company and that, if such a consent could not be provided because of limitations under local law, the U.S. firm could submit a legal opinion describing foreign legal impediments as set forth in the Board's Rule 2105. These firms then engaged in an intensive worldwide effort to determine the need for and, where appropriate, to obtain legal opinions describing foreign law constraints in dozens of countries throughout the world, and these were submitted to the Board as part of the U.S. firms' registrations.

The Board then allowed the firms to register, but in its letters approving firms' registration applications the Board's staff stated an additional legal requirement. In the letter received by Ernst & Young, the Board's staff stated that the firm's "statutory obligation to cooperate" includes a requirement of "obtaining from audit clients and, to the maximum extent practicable, from other third parties any waivers or consents that would overcome any legal obstacle to the associated person's cooperation." No such requirement is set forth either in the Act or in the Board's rules, and this was the first time that the Board or its staff stated that such a requirement exists.

As a result of this PCAOB staff statement, and because of additional and overlapping workpaper-production requirements imposed by Section 106(b) of the Sarbanes-Oxley Act (pursuant to which a foreign accounting firm providing material services on the audit of a U.S. registrant is "deemed to have consented" to production of its audit workpapers), the U.S. firms have informed their U.S. SEC audit clients that they must seek waivers from their majority-owned foreign subsidiaries so that the registered accounting firms can produce workpapers to the PCAOB or SEC without regard to client claims of confidentiality or other rights. The U.S. firms have also required their affiliated non-U.S.

firms to consent to production of their workpapers and related information to the extent they can do so without violating their local law.

We have briefly reviewed the history of this matter because it strikes us as important that an undertaking of this magnitude, with broad international law implications, should be as transparent and open as possible. In addition, there are several related issues that we believe the PCAOB should address, either in the context of this rulemaking or elsewhere.

First, although our firm, and other major accounting firms, have instructed their foreign affiliated firms that they must provide consents, we have made clear that those consents must only be to the extent permitted under the relevant local law. Thus, we have not requested that any foreign firm provide a consent that would require it to violate a relevant local law, such as applicable bank secrecy or other laws. Likewise, we have instructed our clients that they must provide us with waivers of relevant legal impediments, but we have informed them that we are not asking them to waive legal impediments that are not, as a matter of their local law, subject to waiver (for example, bank secrecy or national defense laws in certain jurisdictions might preclude a client from waiving the impediments under these laws, or blocking statutes in some jurisdictions might prevent an effective waiver). Although both of these approaches seem obvious as a matter of international comity and practicality, the approaches have not explicitly been acknowledged, either by the PCAOB in its administration of Section 102 (the registration requirements) or by the PCAOB and SEC in their administration of Section 106 (the auditor workpaper production requirements). We urge the PCAOB (and the SEC) to do so.

Second, we do not know what the Board expects us to do in response to the Board staff's letter relating to waivers from "third parties." The range of possible "third parties" is vast, and the rights they may have under foreign laws are uncertain. Efforts to obtain such waivers would appear to entail a level of complexity and difficulty many times greater even than the complex and difficult efforts currently underway with respect to U.S. SEC audit clients. Guidance on this matter is essential.

Third, although we have instructed our clients that they must provide us with waivers of relevant legal impediments (to the extent such waivers are legally permissible), we cannot inform our clients of the consequences of failing to provide such a waiver, such as whether we might be barred from signing an audit opinion on such a client. This is because we do not know what those consequences might be. We believe that the consequences on an issue of this importance should be known.

Fourth, the U.S. accounting firms, after discussions with counsel for certain audit clients and with others, believed it would be feasible to request their U.S. SEC audit clients to obtain confidentiality waivers from the clients' non-U.S. subsidiaries. However, we have been informed by certain of our non-U.S. accounting firm affiliates that it might not be possible for those firms – when they register with the PCAOB later this year – to instruct their foreign private issuer clients to provide similar waivers from their non-U.S. subsidiaries. We have been told that some of these foreign private issuer clients might conclude that they cannot cooperate in a meaningful way. We believe that further

guidance from, and discussions with, the PCAOB – together with the SEC – on this matter is essential. Non-U.S. companies that avail themselves of the U.S. capital markets have never been required under SEC regulations to waive applicable confidentiality or other protections. Such companies should be advised whether the PCAOB (and the SEC, pursuant to Section 106) interprets the Sarbanes-Oxley Act as erecting such a waiver requirement as a condition of access to the U.S. markets – something that the SEC has never chosen to do. This is a significant regulatory change, and the new regulatory policy should be as clear as possible.

Fifth, despite the enormous efforts being expended obtaining thousands of waivers and consents from entities throughout the world, there is no guarantee that, in the context of an actual financial fraud or audit failure, this new regulatory apparatus will work as intended. The PCAOB and SEC might well need to rely upon traditional enforcement mechanisms, which in an international context must include the involvement and support of foreign governments and regulators. We believe it would be most productive for the PCAOB to continue its efforts in developing cooperative relationships with foreign regulators. In this regard, we are committed to doing what we can to facilitate such arrangements and to strengthen the development of non-U.S. regulatory bodies.

In sum, the extraterritorial reach of the Sarbanes-Oxley Act with respect to non-U.S. accounting firms has created a wide range of complex international law problems. We are fully aware of the challenges confronted by the PCAOB in dealing with its statutorily-mandated responsibilities, and we recognize how determinedly the PCAOB and its staff have been approaching these problems. On our part, the unprecedented new requirements have caused us and the other major accounting firms to commit enormous resources to obtain relevant waivers and consents from thousands of non-U.S. accounting firms and public audit clients. These efforts will be worthwhile if they help achieve an important objective, namely, effective PCAOB and SEC oversight of compliance with SEC and Board regulations. Such oversight is essential to the improvement of audit quality and to the increase of public trust in our profession and the integrity of the financial reporting process. But, to a large extent, we are caught between two oftentimes conflicting sets of requirements: the document production/cooperation requirements of Sections 102 and 106 of the Act, and the professional secrecy, client confidentiality, data protection and other legal impediments of relevant foreign jurisdictions. Accordingly, we have described the worldwide initiatives in this area to emphasize the importance of a consistent acknowledgement by the PCAOB, as well as the SEC, of the limitations imposed by foreign laws and of the need for a clearer and more transparent statement of the goals and requirements in this area.

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We appreciate the opportunity to provide these comments, and we would welcome discussion of any points that require further explanation.

Respectfully submitted,

Ernst & Young LLP