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FINAL RULES RELATING TO THE  
OVERSIGHT OF NON-U.S. PUBLIC  
ACCOUNTING FIRMS

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) PCAOB Release No. 2004-005  
) June 9, 2004  
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) PCAOB Rulemaking  
) Docket Matter No. 013  
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**Summary:** After public comment, the Public Company Accounting Oversight Board (the "Board" or "PCAOB") has adopted rules related to the oversight of non-U.S. accounting firms. The five rules the Board has adopted are PCAOB Rules 4011 and 4012, PCAOB Rule 5113 and PCAOB Rules 6001 and 6002, plus related definitions.

The Board will submit these rules to the Securities and Exchange Commission ("Commission") for approval pursuant to Section 107 of the Sarbanes-Oxley Act of 2002 (the "Act"). The Board's new rules will not take effect unless approved by the Commission.

**Board**

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The Sarbanes-Oxley Act of 2002 directs the Board to, among other things, establish a registration system and inspection and enforcement programs for accounting firms that audit or play a substantial role in the audit of issuers.<sup>1/</sup> Section 106(a) of the Act provides that non-U.S. public accounting firms are subject to the Act

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<sup>1/</sup> See the Act and the rules of the Board.

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and the rules of the Board and the Commission issued under the Act in the same manner and to the same extent as a U.S. public accounting firm.

To address the special issues raised by non-U.S. firms, the Board developed a framework under which the Board could implement the Act's provisions by relying, to an appropriate degree, on a non-U.S. oversight system. This framework is described in PCAOB Release No. 2003-020, Briefing Paper on the Oversight of Non-U.S. Public Accounting Firms (October 28, 2003) (the "Briefing Paper"). The Briefing Paper was followed by proposed rules, which generally articulated the Briefing Paper's framework for cooperation between the PCAOB and its counterparts in other countries.<sup>2/</sup> The Board's adoption of final rules concludes this process.

The five rules the Board has adopted are PCAOB Rules 4011 and 4012, PCAOB Rule 5113 and PCAOB Rules 6001 and 6002, plus related definitions. The text of these rules and a detailed discussion of each are attached as Appendices 1 and 2, respectively. Section A of this release provides background information relating to the development of the Board's approach to the oversight of non-U.S. firms. Section B provides a general overview of the operation of the rules. Section C describes the changes made to the rules in response to public comments.

### A. Background

As discussed in the Briefing Paper, the Board has engaged in a constructive dialogue with non-U.S. regulators concerning reforms in the oversight of accounting firms that audit public companies and the possible development of a cooperative arrangement for such oversight. This dialogue has demonstrated that the Board and its foreign counterparts share many of the same objectives. These include protecting investors from inaccurate financial reporting, improving audit quality, ensuring effective and efficient oversight of accounting firms, and helping to restore the public trust in the auditing profession.

As also explained in the Briefing Paper, underlying this convergence of views is the global nature of the capital markets. Because of the global nature of these markets, the effects of a corporate reporting failure in one country tend to ripple through the financial markets of another, potentially causing substantial economic damage. The

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<sup>2/</sup> PCAOB Release No. 2003-024, Proposed Rule on Oversight of Non-U.S. Firms (December 10, 2003).

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Board believes that the best way to fulfill its mission – that is, protection of investors in the U.S. markets – is to participate in global efforts to protect investors in all markets. To that end, the Board believes that it is in the interests of the public, investors and the Board's non-U.S. counterparts to develop an efficient and effective cooperative arrangement where reliance may be placed on the home-country system to the maximum extent possible.

The Board hopes that its approach to oversight of non-U.S. public accounting firms will encourage improvements in audit quality for firms in jurisdictions that have or create independent and rigorous auditor oversight systems. Already, significant changes in the regulation of non-U.S. accounting firms have occurred in certain jurisdictions, including a number of proposals for the creation of new bodies to improve audit quality and verify compliance with local auditing and related professional practice standards.

The Board's approach towards the oversight of non-U.S. firms endeavors to build upon the work of these new bodies – and, where available, existing bodies – in order to minimize administrative burdens and legal conflicts that firms face and to conserve Board resources, without undermining or ignoring the Board's statutory mandates.

The cooperative approach envisaged by the Board in the Briefing Paper and reflected in the final rules also addresses potential conflicts of law that may arise in connection with an inspection or an investigation. The Board believes that it is appropriate that a cooperative approach respect the laws of other jurisdictions, to the extent possible. At the same time, every jurisdiction must be able to protect the participants in, and the integrity of, its capital markets as it deems appropriate. Thus, the Board believes that a cooperative approach in which the Board works in the first instance with the home-country system to attempt to resolve potential conflicts of laws reflects the appropriate balance between the interests of different systems and their laws.

### **B. Overview of Board's Rules**

The rules adopted address the Board's oversight of non-U.S. accounting firms that register with the Board and the Board's willingness to assist non-U.S. authorities in their oversight of U.S. firms.

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The Board's rules on inspections (PCAOB Rules 4011 and 4012) provide a foreign registered public accounting firm an opportunity to minimize the unnecessarily duplicative administrative burdens of dual oversight by requesting that the Board rely – to an extent deemed appropriate by the Board – on inspections of the registered firm under the home country's oversight system. Under the Board's rules, a firm would first provide the Board with a one-time statement asking the Board to rely on a non-U.S. inspection. At an appropriate time before each inspection of a non-U.S. firm that has submitted such a statement, the Board would determine the appropriate degree of reliance based on information about the non-U.S. system obtained primarily from the non-U.S. regulator regarding the independence and rigor of the non-U.S. system. The Board would also base its decision on its discussions with the appropriate entity or entities within the oversight system concerning the specific inspection work program for the non-U.S. firm's inspection at hand. The more independent and rigorous a home-country system, the higher the Board's reliance on that system. A higher level of reliance translates into less direct involvement by the Board in the inspection of the non-U.S. registered public accounting firm.

The Board's rule on investigations (PCAOB Rule 5113) provides that the Board may, in appropriate circumstances, rely upon the investigation or sanction, if any, of a foreign registered public accounting firm by a non-U.S. authority. The Board's reliance would depend, in part, on the independence and rigor of the non-U.S. authority. Reliance also may depend on the non-U.S. authority's willingness to update the Board regarding the investigation on a regular basis and its willingness and authority to share the relevant evidence gathered with the Board.

The Board has also adopted two rules reflecting its willingness to assist non-U.S. authorities in their oversight of firms located in the U.S. and registered with the Board. PCAOB Rule 6001 relates to inspections and provides that the Board may, as it deems appropriate, assist a non-U.S. authority in its inspection of a registered U.S. firm. PCAOB Rule 6002 relates to investigations and provides that the Board may, as it deems appropriate and to the extent permitted by law, assist a non-U.S. authority in the investigation of a registered U.S. accounting firm.

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### C. Public Comment Process and Board Responses

The Board released its proposed rules on the oversight of non-U.S. firms on December 10, 2003. The Board received 22 written comment letters.<sup>3/</sup> In response to these comments, the Board's rules both clarify and modify certain aspects of the proposal. Most significantly, the changes include –

- eliminating proposed Exhibit 99.3 to Form 1 which would have allowed an applicant an option to provide the name and physical address of the applicant's foreign registrar or any other authority responsible for regulation of the applicant's practice of accounting;
- eliminating the requirement that a foreign registered public accounting firm submit a petition that describes the laws, rules and/or other information of the non-U.S. system;
- adding a requirement that a foreign registered public accounting firm that seeks to have the Board rely on a non-U.S. inspection provide a written statement, signed by an authorized partner or officer of the firm, certifying that the firm seeks such reliance for inspections conducted by the Board;
- inserting within the text of the rule the illustrative criteria that the Board may consider when determining the degree, if any, to which the Board may rely on a non-U.S. inspection;
- adopting a rule providing that the Board may, as it deems appropriate, provide assistance in an inspection of a registered public accounting firm pursuant to the laws and/or regulations of a non-U.S. jurisdiction; and
- adopting a rule where the Board may, as it deems appropriate, provide assistance in an investigation of a registered public accounting firm pursuant to the laws and/or regulations of a non-U.S. jurisdiction.

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<sup>3/</sup> The Board's responses to the comments are discussed in more detail in the section-by-section analysis in Appendix 2. The comment letters are available on the Board's Web site – [www.pcaobus.org](http://www.pcaobus.org) – and will be attached to the Form 19b-4 that the Board will file with the Commission.

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On the 9th day of June, in the year 2004, the foregoing was, in accordance with the bylaws of the Public Company Accounting Oversight Board,

ADOPTED BY THE BOARD.

/s/ J. Gordon Seymour

J. Gordon Seymour  
Acting Secretary

June 9, 2004

APPENDICES –

1. Rules Relating to the Oversight of Non-U.S. Public Accounting Firms
2. Section-by-Section Analysis of Rules Relating to Oversight of Non-U.S. Firms

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**Appendix 1 – Rules Relating to the Oversight  
of Non-U.S. Public Accounting Firms**

**RULES**

**SECTION 1. GENERAL PROVISIONS**

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**Rule 1001. Definitions of Terms Employed in Rules.**

When used in the Rules, unless the context otherwise requires:

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**(f)(ii) Foreign Registered Public Accounting Firm**

The term "foreign registered public accounting firm" means a foreign public accounting firm that is a registered public accounting firm.

**(n)(iii) Non-U.S. Inspection**

The term "non-U.S. inspection" means an inspection of a foreign registered public accounting firm conducted within a non-U.S. oversight system.

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**SECTION 4. INSPECTIONS**

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**Rule 4011. Statement by Foreign Registered Public Accounting Firms**

A foreign registered public accounting firm that seeks to have the Board rely, to the extent deemed appropriate by the Board, on a non-U.S. inspection when the Board conducts an inspection of such firm pursuant to Rule 4000 shall submit a written statement signed by an authorized partner or officer of the firm to the Board certifying that the firm seeks such reliance for all Board inspections.

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### Rule 4012. Inspections of Foreign Registered Public Accounting Firms

(a) If a foreign registered public accounting firm has submitted a statement pursuant to Rule 4011, the Board will, at an appropriate time before each inspection of such firm, determine the degree, if any, to which the Board may rely on the non-U.S. inspection. To the extent consistent with the Board's responsibilities under the Act, the Board will conduct its inspection under Rule 4000 in a manner that relies to that degree on the non-U.S. inspection. In making that determination, the Board will evaluate –

(1) information concerning the level of the non-U.S. system's independence and rigor, including the adequacy and integrity of the system, the independence of the system's operation from the auditing profession, the nature of the system's source of funding, the transparency of the system, and the system's historical performance; and

(2) discussions with the appropriate entity or entities within the system concerning an inspection work program.

(b) The Board's evaluation made pursuant to paragraph (a) may include, but not be limited to, consideration of –

(1) the adequacy and integrity of the system, including –

(i) whether the system has the authority to inspect audit and review engagements, evaluate the sufficiency of the quality control system, and perform such other testing as deemed necessary of foreign public accounting firms; and whether the system can exercise such authority without the approval of, or consultation with, any person affiliated or otherwise connected with a public accounting firm or an association of such persons or firms;

(ii) whether the system has the authority to conduct investigations and disciplinary proceedings of foreign public accounting firms, any persons of such firms, or both, that may have violated the laws and standards relating to the issuance of audit reports, and whether the system can exercise such authority without the approval of, or consultation with, any person affiliated or otherwise connected with a public accounting firm or an association of such persons or firms;



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(iii) whether the system has the authority to impose appropriate sanctions for violations of the non-U.S. jurisdiction's laws and standards relating to the issuance of audit reports, and whether the system can exercise such authority without the approval of, or consultation with, any person affiliated or otherwise connected with a public accounting firm or an association of such persons or firms; and

(iv) whether the persons within the system have adequate qualifications and expertise;

(2) the independence of the system from the auditing profession, including –

(i) whether the system has the authority to establish and enforce ethics rules and standards of conduct for the individual or group of individuals who govern the system and its staff and has prohibited conflicts of interest, and whether the system can exercise such authority without the approval of, or consultation with, any person affiliated or otherwise connected with a public accounting firm or an association of such persons or firms;

(ii) whether the person or persons governing the system –

(A) have been appointed, or otherwise selected, by the government of the non-U.S. jurisdiction, without the approval of, or consultation with, any person affiliated or otherwise connected with a public accounting firm or an association of such persons or firms; and

(B) may be removed only by the government of the non-U.S. jurisdiction and may not be removed by any person affiliated or otherwise connected with a public accounting firm or an association of such persons or firms;

(iii) whether a majority of the individuals with whom the system's decision-making authority resides do not hold licenses or certifications authorizing them to engage in the business of auditing or accounting and did not hold such licenses or certificates for at least the last five years immediately before assuming their position within the system;

(iv) whether a majority of the individuals with whom the system's decision-making authority resides, including the individual who functions as the entity's chief executive or equivalent thereof, are not practicing public accountants; and

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(v) whether each entity within the system has the authority to conduct its day-to-day operations without the approval of any person affiliated or otherwise connected with a public accounting firm or an association of such persons or firms;

(3) the source of funding for the system, including whether the system has an appropriate source of funding that is not subject to change, approval or influence by any person affiliated or otherwise connected with a public accounting firm or an association of such persons or firms;

(4) the transparency of the system, including whether the system's rulemaking procedures and periodic reporting to the public are openly visible and accessible; and

(5) the system's historical performance, including whether there is a record of disciplinary proceedings and appropriate sanctions, but only for those systems that have existed for a reasonable period of time.

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**SECTION 5. INVESTIGATIONS AND ADJUDICATIONS**

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**Part 1 – Inquiries and Investigations**

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**Rule 5113. Reliance on the Investigations of Non-U.S. Authorities**

Upon the recommendation of the Director of Enforcement and Investigations or upon the Board's own motion, the Board may, in appropriate circumstances, rely upon the investigation or a sanction, if any, of a foreign registered public accounting firm by a non-U.S. authority.

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**SECTION 6. INTERNATIONAL**

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**Rule 6001. Assisting Non-U.S. Authorities in Inspections**

The Board may, as it deems appropriate, provide assistance in an inspection of a registered public accounting firm organized and operating under the laws of the United States conducted pursuant to the laws and/or regulations of a non-U.S. jurisdiction. The Board may consider the independence and rigor of the non-U.S. system in determining the extent of the Board's assistance.

**Rule 6002. Assisting Non-U.S. Authorities in Investigations**

The Board may, as it deems appropriate, provide assistance in an investigation of a registered public accounting firm organized and operating under the laws of the United States conducted pursuant to the laws and/or regulations of a non-U.S. jurisdiction. The Board may consider the independence and rigor of the non-U.S. system in determining the extent of the Board's assistance.

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**Appendix 2 – Section-by-Section Analysis of Rules Relating to Oversight of Non-US. Firms**

**Rule 1001 – Definitions of Terms Employed in Rules**

*Foreign Registered Public Accounting Firm*

The term "foreign registered public accounting firm" in Rule1001(f)(ii) means a foreign public accounting firm that is a registered public accounting firm.

*Non-U.S. Inspection*

The term "*non-U.S. inspection*" in Rule1001(n)(iii) means an inspection of a foreign registered public accounting firm conducted within a non-U.S. oversight system.

**Rule 4011 – Statement by Foreign Registered Public Accounting Firm**

PCAOB Rule 4011 states that a foreign registered public accounting firm that seeks to have the Board rely on a non-U.S. inspection when the Board conducts an inspection of such firm pursuant to PCAOB Rule 4000 shall submit a written statement signed by an authorized partner or officer of the firm to the Board certifying that the firm seeks such reliance for Board inspections.

The Board's proposed rule would have required that foreign registered public accounting firms submit to the Board a written petition, in English, describing the non-U.S. system's laws, rules and/or other information to assist the Board in evaluating such system's independence and rigor. Many commenters argued that this requirement was

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neither practical nor effective, that different public accounting firms within the same jurisdiction may translate and describe the system differently, and that non-U.S. regulators, rather than public accounting firms, are in a better position to describe the non-U.S. system, as they may possess information unknown by a foreign registered public accounting firm.

In response to these comments, the Board has decided not to impose the petition requirement. The Board's rule does not require a foreign registered public accounting firm to describe its oversight system, including its legal underpinnings. As explained more fully below, under PCAOB Rule 4012, the Board will, at an appropriate time, obtain information about the non-U.S. system directly from the appropriate non-U.S. regulator.

Instead of requiring a petition, the Board has adopted a rule permitting a foreign registered public accounting firm to submit a one-time statement certifying that it seeks to have the Board rely on a non-U.S. inspection when the Board conducts an inspection pursuant to PCAOB Rule 4000. This statement may be submitted at any time after the foreign public accounting firm's registration application has been approved by the Board. The statement, which must be signed by an authorized partner or officer of the firm, should be addressed to the attention of the Secretary and may be submitted via

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post or electronic mail (secretary@pcaobus.org). If the statement is submitted via electronic mail, the words "Rule 4011 Statement" must be included in the subject line.

The Board believes that a foreign registered public accounting firm's one-time statement, which is not associated with any specific Board inspection, should resolve the concern expressed by some commenters that proposed PCAOB Rule 4011 would have left unclear when a foreign registered public accounting firm should submit the earlier proposed petition. Commenters indicated that some non-U.S. jurisdictions are in the process of developing new auditor oversight regimes or otherwise modifying their existing regimes. Those commenters were uncertain whether their petitions would need to be submitted immediately and then updated as changes occurred, or if they should wait until the changes to their local oversight regimes were finalized. Because the one-time statement is not associated with a specific Board assessment for a specific Board inspection under new PCAOB Rule 4012 and no longer includes any description requirements of the non-U.S. system, a foreign registered public accounting firm may submit the statement without waiting for the finalization of any potential changes to its oversight regime. Of course, if the foreign registered public accounting firm is selected for inspection before the finalization of changes to its non-U.S. system, the Board would make a reliance determination under PCAOB Rule 4012 based on the system in place at the time of the determination. As explained more fully below, finalization of changes

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in a non-U.S. system that affects a system's independence or rigor would necessitate a review of the Board's previous determination.

In addition, in response to comments, the Board has eliminated the proposed Exhibit 99.3 to Form 1, which would have allowed an applicant an option to provide the name and physical address of the applicant's foreign registrar or any other authority responsible for regulation of the applicant's practice of accounting. The Board believes it is more efficient for the Board to identify the appropriate non-U.S. regulator itself, rather than have a non-U.S. public accounting firm submit an additional exhibit to the Board through the registration system.

It should be noted that PCAOB Rule 4011 (and PCOAB Rule 4012) are not limitations on the Board. Thus, even if a non-U.S. registered public accounting firm does not choose to submit a statement pursuant to Rule 4011, the Board may take steps it determines are necessary to facilitate the inspection of such firm through the cooperative framework.

### **Rule 4012 – Inspections of Foreign Registered Public Accounting Firms**

The Board has reorganized much of the substance, with some modification, of proposed PCAOB Rule 4011 into PCAOB Rule 4012. PCAOB Rule 4012 provides that the Board shall determine the degree, if any, it may rely on a non-U.S. inspection of a foreign registered public accounting firm that has submitted a statement pursuant to



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PCAOB Rule 4011. The Board will make such determination at an appropriate time before each inspection of such firm. In making that determination, the Board will evaluate (1) information concerning the level of the non-U.S. system's independence and rigor, including the adequacy and integrity of the system, the independence of the system's operation from the auditing profession, the nature of the system's source of funding, the transparency of the system, and the system's historical performance and (2) discussions with the appropriate entity or entities within the system concerning an inspection work program for the particular firm. The Board will consider certain illustrative criterion, now listed in the rule, in applying the broad principles articulated in PCAOB Rule 4012. PCAOB Rule 4012 also provides that the Board shall conduct its inspection under PCAOB Rule 4000 in a manner that relies on non-U.S. inspections, to the degree determined by the Board and to the extent consistent with the Board's responsibilities under the Act.

The Board received wide-ranging comments on the Board's proposal for determining the appropriate degree of reliance, including concerns about the Board's fundamental approach to oversight of foreign registered public accounting firms to requests for clarification or change to the Board's process for assessing a non-U.S. system.

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After careful consideration of the comments, the Board has made certain changes to the proposed rule and offers clarification in other areas, each of which is explained below.

### **A. Comments on the Board's Overall Approach**

With regard to the Board's overall approach, some commenters argued that the Board should adopt a "mutual recognition" model whereby the Board would accord complete deference to the home-country regulator in the areas of inspections, investigations and sanctions. Similarly, one commenter suggested that the Board should not issue its own inspection report for a foreign registered public accounting firm, but instead should rely on the report of the non-U.S. regulator.

The Board does not believe that a "mutual recognition" approach would be in the interests of U.S. investors or the public. While the Board is hopeful that it will be able to place a high degree of reliance on certain non-U.S. systems of oversight, the Board believes that it must preserve the ability to participate fully and directly in the inspection, investigation and sanction of foreign registered public accounting firms if warranted by the particular facts and circumstances. Under the Act, the Board's mission is to oversee the auditors of issuers in order to protect the interests of investors and further the public interest in the preparation of informative, fair, and independent audit reports. More specifically, the Board is required by the Act to conduct inspections in order to assess

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the registered public accounting firm's compliance with U.S. laws, regulations and professional standards. Because non-U.S. regulatory authorities do not have this same mission, deferring to those authorities regardless of the circumstances would not be in the interests of U.S. investors or the public.

Several commenters criticized the principles and related criteria that the Board would consider in evaluating the independence and rigor of a non-U.S. system as disproportionately based on the principles and related criteria that underlie the oversight system in the United States. These commenters suggested that the Board would place a high level of reliance only on those non-U.S. systems that were identical or substantially similar to the Board.

The Board has previously stated that it believes that the "sliding scale" approach can accommodate a variety of oversight systems. The Board does not intend to require that non-U.S. systems be identical or even substantially similar to the PCAOB in order for the Board to place a high level of reliance on them.

That said, the Act and its creation of an independent public oversight entity for auditors (the PCAOB) reflect the view of the U.S. Congress that the self-regulatory system used to ensure high quality audits for U.S. issuers was not adequate. Thus, in determining the degree to which the Board may rely on a non-U.S. regulator to conduct inspections of firms located abroad that audit companies whose securities trade in U.S.

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markets, it is appropriate for the Board to evaluate that regulator in light of the principles that underlie the creation of the PCAOB. As explained in the proposing release, however, the listed criteria are not exhaustive, and the presence or absence of any one of the criteria would not necessarily be dispositive. The Board intends to assess the structure and operation of a non-U.S. system as a whole, and not base its decision on whether that system meets a certain number of the criteria.

### **B. Comments on Board's Assessment – Application of Principles and Criteria**

In response to comments, the illustrative criteria the Board may consider in evaluating a non-U.S. system has been moved from the body of the release into the text of PCAOB Rule 4012.

With regard to the application of the principles and criteria, some commenters urged the Board to evaluate a non-U.S. system's independence and rigor on a country-by-country basis rather than firm-by-firm. Those commenters expressed concern that the Board may draw different conclusions with respect to foreign registered public accounting firms that are subject to the same non-U.S. system.

The Board intends to evaluate a non-U.S. system's independence and rigor on a country-by-country basis so that the conclusion regarding its independence and rigor will be the same for all non-U.S. registered public accounting firms within that system. Of course, each time a firm is selected for inspection, the Board would reconfirm that

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assessment in light of any changes that may have occurred to the non-U.S. system. In addition to the Board's consideration of the independence and rigor of a non-U.S. system, however, the Board must also consider the discussions with the non-U.S. regulator regarding the inspection work program for the individual non-U.S. registered public accounting firm selected for inspection. Because an inspection work program is specific to an individual non-U.S. registered public accounting firm, the Board's ultimate determination under PCAOB Rule 4012 can be made only on a firm-by-firm basis.

Some commenters urged the Board to describe precisely how the Board would weigh each of the listed criteria. Others urged the Board to avoid weighing certain criteria too heavily, including 1) whether members that govern the oversight system were appointed by the government, and 2) whether a majority of members hold licenses to practice public accounting.

The proposing release stated that the listed criteria are not intended to be exhaustive, and that the presence or absence of any one of the criteria would not necessarily be dispositive. The Board continues to believe that it should not, in the abstract, specify a weight for individual criterion. Assigning a rigid weight to each criterion would create a "check-the-box" process that could result in the form and structure of an oversight system (rather than the substance within the system) having an inappropriate role in the Board's determination. Oversight systems may differ in

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form, structure and complexity and therefore meet different criteria in different ways, but they nevertheless may achieve the principles in PCAOB Rule 4012 in an equally effective manner. Consequently, the Board does not believe it is appropriate to create a rigid evaluation process that inadvertently penalizes an independent and rigorous system as a result of the Board's use of predetermined weights for the listed criteria. Instead, as explained above, the Board's rule permits the Board to analyze a non-U.S. system as a whole.

Other commenters requested that the Board define the term "any other information," as used in proposed PCAOB Rule 4011(c)(2). The Board's modification of the proposed rule no longer includes those specific words. However, the Board's rule indicates the Board will evaluate *any* information that comes to its attention concerning the level of the non-U.S. system's independence and rigor. In other words, the Board does not intend to exclude any information due to its source. Of course, the Board will take into account the source of the information in considering the probative value of the information.

Several commenters argued that the proposed rule permits the Board unlimited discretion and therefore creates an unacceptable level of uncertainty with respect to the application of the rule in practice. The Board has decided against modifying the rule in response to these comments. While the Board retains the discretion to design

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inspection programs under the Act, the Board believes that the stated principles and criteria allow interested parties enough information to estimate reasonably the extent of reliance on a home-country inspection. In addition, the Board expects the level of uncertainty in a specific jurisdiction to subside as the Board begins to implement the rule.

A few commenters expressed concern that the criteria did not include consideration of whether those that govern have appropriate qualifications and expertise. The Board agrees and has included criteria related to the qualifications and expertise of persons within the non-U.S. system.

Another commenter suggested that the Board's criteria do not address financial, business or personal independence risks. As stated in the proposing release, the Board would consider whether an entity within the system has the authority to establish and enforce ethics rules and standards of conduct for an individual or a group of individuals that govern the system and associated staff. The Board believes this criterion captures the risks related to independence. As part of its assessment process, the Board could consider certain points raised by the specific policies of a code of ethics or a code of conduct and their impact on the independence of the system.

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### **C. Comments on the Board's Assessment – Process**

In addition to the substance of the Board's assessment under the proposed rule, several commenters argued that the Board should make changes to the *process* surrounding the Board's reliance determination.

First, a number of commenters urged the Board to allow an appeal of its reliance determination. The Board has decided against permitting an appeal of the Board's determination. Under the Act, the design and implementation of an inspection work program is within the discretion of the Board. It follows that, because the Board's decision regarding the appropriate degree of reliance, if any, is essentially a decision regarding the design and implementation of inspection work programs for non-U.S. registered public accounting firms, such decision is also properly within the Board's discretion. The Act does not provide for an appeal of the Board's design of such programs. In addition, allowing such an appeal would potentially permit a non-U.S. registered public accounting firm to impede the Board's ability to discharge its obligation under the Act to assess the compliance of that firm with U.S. laws and standards.

Some commenters asserted that the Board should be required to communicate the basis for the Board's determination to the public and representatives of the non-U.S. system. In response to these comments, the Board intends to provide a general description of its activities with representatives of non-U.S. systems either as part of its



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annual report to the public or in a separate public report to make the Board's processes under its framework more transparent. As a practical matter, representatives of the non-U.S. system will be informed of the basis for the Board's assessment as a natural part of the dialogue between the Board and those representatives. Under the framework for cooperation created by the Board's rules, a dialogue will take place between the Board and representatives of the non-U.S. system regarding the structure and operation of such system as well as the content of the inspection work programs for the non-U.S. registered public accounting firms within that system.

Another commenter urged that the Board require itself to maintain its initial assessment unless a formal request to change the assessment is made by the non-U.S. registered public accounting firm or alternatively that the Board provides advance notice of its intent to change its assessment determination. PCAOB Rule 4012 provides that the Board will conduct its inspection under PCAOB Rule 4000 in accordance with its reliance determination to the extent consistent with the Board's responsibilities under the Act. The Board intends to maintain its initial assessment unless there is a change in circumstances subsequent to such determination that necessitates a review of that determination. Generally, such circumstances would include changes in the non-U.S. system that affects the system's independence or rigor or changes in the willingness or ability of a non-U.S. regulator to cooperate with the Board in the inspection of a non-

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U.S. registered public accounting firm. It would not be in the interest of U.S. investors or the public for the Board to wait, notwithstanding a change in the system, until a non-U.S. registered public accounting firm requested a new assessment. If the Board determines that a change in its prior assessment is warranted, the non-U.S. regulator will be informed, again, as a part of the dialogue between that regulator and the Board.

Another commenter suggested that the Board should be required to provide a non-U.S. registered public accounting firm a copy of any written correspondence between the Board and the non-U.S. regulator. The Board disagrees. Providing the subject of the inspection process (i.e., the registered firm) access to such correspondence could permit the firm subject to inspection an opportunity to be aware of the certain details regarding the inspection work program to be used during the inspection of such firm, as well as inhibit frank and open discussions between the Board and the non-U.S. regulator.

One commenter urged the Board to require that its reliance determination be made within a specified time frame. First, PCAOB Rule 4012 already contains a deadline in that it requires that the Board complete discussions and make a determination at an appropriate time *before* the inspection of a registered non-U.S. firm begins. Second, otherwise permitting flexibility in the amount of time allowed is necessary for the Board to engage in a constructive regulator-to-regulator dialogue

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about the structure and operation of the non-U.S. system and the requirements of a specific firm's inspection. Thus, the Board has declined to modify the rule to require the Board to make its determination within a shorter or more specific time frame.

Some commenters stressed that the Board should not weigh unfavorably a non-U.S. regulator's "willingness" to provide access to information when they are prevented from doing so by an asserted conflict of law. As discussed in more detail below, the cooperative framework implemented through these rules may not resolve all potential legal conflicts. Thus, if a non-U.S. regulator is unable to share information, then that factor must be taken into account in the Board's decision on whether it is in the interest of U.S. investors and the public to rely on that regulator. Whether the regulator's inability to share information is weighed "heavily" will depend on the facts and circumstances at hand. Under the Act, the Board must assess each registered public accounting firm's compliance with U.S. laws and standards. A regulator's inability to share information could prevent the Board from making such assessment, which in turn, would prevent the Board from discharging its responsibilities under the Act.

Other commenters noted specifically that potential conflicts of law remain unresolved under the Board's proposed rules and urged the Board to adopt a rule similar to PCAOB Rule 2105 for inspections and investigations of foreign registered public accounting firms. Another commenter requested clarification regarding whether a

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submission made pursuant to PCAOB Rule 2105 in connection with a registration application applies to potential conflicts of law that may arise subsequent to registration and whether a non-U.S. registered public accounting firm's inability to cooperate due to those subsequent conflicts could subject such firm to disciplinary action. The commenter also requested clarification regarding whether a submission made pursuant to PCAOB Rule 2105 is also valid for the so-called "deemed consent" under Section 106 of the Act.

First, to clarify, PCAOB Rule 2105 provides the requirements for applicants that wish to withhold information from their applications for registration with the Board. The rule does not apply to potential conflicts of law that may arise subsequent to registration and does not affect the deemed consent under Section 106 of the Act.

Second, the Board recognizes that its rules relating to the oversight of non-U.S. registered public accounting firms do not conclusively resolve potential conflicts of law. Preserving the Board's ability to access audit work papers and other documents or information maintained by registered public accounting firms, including non-U.S. registered public accounting firms, is critical to the Board carrying out its obligations under the Act. Consequently, the Board does not believe that it is in the interests of U.S. investors or the public for the Board to adopt a rule of general application that

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would limit its ability to access such documents or information regardless of the circumstances or need for those documents or information.

Instead, as explained in the Briefing Paper, the Board envisages that potential conflicts of law that may arise in connection with an inspection or an investigation can be addressed through the cooperative approach. The Board continues to believe that most conflicts of law can be resolved through an approach in which the Board works in the first instance with the non-U.S. regulator or through the use of special procedures such as voluntary consents and waivers. As previously explained, the Board believes that it is appropriate that a cooperative approach respect the laws of other jurisdictions, to the extent possible. At the same time, every jurisdiction must be able to protect the participants in, and the integrity of, its capital markets as it deems necessary and appropriate. The Board believes that working with non-U.S. regulators in the first instance to overcome asserted conflicts of law reflects the appropriate balance between the interests of different systems and their laws.

The comments urging the Board to adopt a rule similar to PCAOB Rule 2105 for inspections and investigations seem to reflect the view that PCAOB Rule 2105 offers an opportunity for resolution to conflicts of law that are asserted during the registration process. Such interpretation is not correct. If the Board decides to treat a registration application in which information is withheld pursuant to PCAOB Rule 2105 as complete,

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such action by the Board would not constitute a concession that the non-U.S. law does in fact prohibit the applicant from supplying the information and would not preclude the Board from contesting that assertion in other contexts.

In other words, PCAOB Rule 2105 does not offer an absolute safe-harbor for public accounting firms that assert a conflict of laws. PCAOB Rule 2105 provides an opportunity for the public accounting firm to be heard on an asserted conflict of law in the context of registration. Although not set out in a separate rule, a similar opportunity to be heard regarding asserted conflicts of law that may arise in the context of inspections and investigations is already provided under the Act and the Board's rules regarding disciplinary hearings.

For those asserted conflicts of law that arise during an inspection or investigation and cannot be resolved by working with the appropriate non-U.S. regulator, by the use of voluntary waivers or consents, or by other means,<sup>1/</sup> the Board's rules provide the registered public accounting firm with an opportunity to present its position to the Board regarding the asserted legal conflict before any action is taken by the Board. If the Board cannot fully conduct an inspection or investigation in a timely manner due to an asserted conflict of law, the Board may consider whether the non-U.S. registered public

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<sup>1/</sup> The Board hopes to resolve potential conflicts of law as part of its discussions with a non-U.S. regulator under PCAOB Rule 4012 *before* the inspection of a non-U.S. registered public accounting firm.

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accounting firm should be sanctioned by the Board for non-cooperation. Under the Act and the Board's rules regarding disciplinary proceedings and hearing procedures, before any sanction may be imposed, a registered public accounting firm will have an opportunity to be heard before an independent hearing officer regarding the asserted conflict of law and whether revocation of its registration is an appropriate sanction. The registered public accounting firm's rights under the Act and the Board's rules include appeal of the hearing officer's decision to the Board, appeal of the Board's decision to the Commission and appeal of the Commission's decision to the court of appeals.

To be clear, the Board is not suggesting that it would in all cases commence a non-cooperation proceeding when a firm asserts a conflict of law that cannot be resolved. As previously explained, the Board expects that most conflicts of laws can be resolved by working with the appropriate non-U.S. regulator, through the use of voluntary waivers or consents, or other means. The point is that a rule like PCAOB Rule 2105 is not needed in the context of inspections and investigations because a similar opportunity to be heard is already provided.

Finally, some commenters sought clarification about the participation of "experts" who are designated by the Board in inspections where the Board has determined that a high level of reliance is appropriate. The Board expects that the participation of at least one Board-designated expert in U.S. Generally Accepted Accounting Principles,

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PCAOB standards and other U.S. professional standards and law will be necessary on all inspections of non-U.S. registered public accounting firms. After the Board has conducted initial inspections through the cooperative framework with the cooperation of the non-U.S. regulator, however, the Board may designate an outside expert who is not a PCAOB employee to participate in the inspection.

### **Rule 5113 – Reliance on the Investigations of Non-U.S. Authorities**

PCAOB Rule 5113 provides that the Board may, in appropriate circumstances, rely upon the investigation or sanction, if any, of a non-U.S. registered public accounting firm by a non-U.S. authority. The Board's reliance would depend, in part, on the independence and rigor of the non-U.S. authority. Reliance also may depend on the non-U.S. authority's willingness to update the Board regarding the investigation on a regular basis and its willingness and authority to share the relevant evidence gathered with the Board.<sup>2/</sup>

Circumstances may require, however, that the Board conduct an investigation relating to the audit work of a non-U.S. registered public accounting firm, or an associated person of such a firm, in connection with the financial statements of an issuer. PCAOB Rule 5113 does not limit the Board's authority under PCAOB Rule 5200

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<sup>2/</sup> Of course, PCAOB Rule 5113 does not apply to investigations or sanctions carried out by the Securities and Exchange Commission.



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to commence disciplinary proceedings whenever it appears to the Board that such action is warranted.

Some commenters noted that, because PCAOB Rule 5113 does not definitively limit the Board's authority to initiate an investigation or impose sanctions, it poses the risk that a non-U.S. registered public accounting firm may be subject to an investigation and sanction by both the Board and a non-U.S. authority. One commenter suggested that, because of this risk, the Board should limit its authority and defer to the non-U.S. regulator in matters of investigation and sanction.

The Board has declined to change the rule in response to these comments. As explained earlier, the Board's mission is to oversee the auditors of issuers in order to protect the interests of investors and further the public interest in the preparation of informative, fair, and independent audit reports. Because non-U.S. regulatory authorities do not have the same mission, restricting the Board's authority to conduct investigations or impose sanctions on non-U.S. registered public accounting firms by deferring to non-U.S. authorities – in every case – would not be consistent with the Board's obligations under Section 105 of the Act.

In any event, the Board does not believe that PCAOB Rule 5113 poses a risk of "double jeopardy" for a registered firm. The Board has the authority to investigate and discipline registered public accounting firms only for potential violations of U.S. laws,

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regulations and professional standards. To the extent that a foreign registered public accounting firm's conduct violates laws in two separate jurisdictions, the foreign registered public accounting firm has chosen to subject itself to the laws of those jurisdictions by choosing to operate in multiple jurisdictions.

That said, as the Board explained in the Briefing Paper, when a non-U.S. disciplinary regime provides for appropriate sanctions of non-U.S. registered public accounting firms and individuals and that regime adequately serves the public interest and protects investors, the Board intends to rely, as appropriate, on the work of the other disciplinary system. Certain circumstances, however, may require the PCAOB to conduct the investigation of a non-U.S. registered public accounting firm relating to its audit of an issuer or to impose sanctions beyond those imposed by the non-U.S. system. In doing so, the Board may consider the sanctions of the non-U.S. system when determining the appropriate sanction in the United States.

Several commenters requested that the Board clarify the meaning of the phrase "in appropriate circumstances" in PCAOB Rule 5113 or otherwise provide more detail regarding the circumstances under which the Board would choose to rely on a non-U.S. authority in the context of an investigation. Similarly, one commenter suggested that the Board's approach to inspections and investigations of non-U.S. registered firms

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should be identical, and therefore that the Board should define the conditions for relying on a non-U.S. authority under PCAOB Rule 5113.

While the request for more detail is understandable, the Board has declined to define the phrase "in appropriate circumstances" as the facts and circumstances of any investigation are not predictable. The Board believes it is necessary to preserve a high level of flexibility to decide whether reliance on a non-U.S. authority in an investigation context is in the interest of U.S. investors and the public and would otherwise permit the Board to satisfy its responsibilities under the Act.

In addition, the Board does not believe that its approach to investigations is "inconsistent" with its approach to inspections of non-U.S. registered public accounting firms. Investigations and inspections are different in nature and are governed under different sections of the Act and, therefore, warrant different approaches. Investigations, which are addressed by Section 105 of the Act, are premised on a possible violation of U.S. law, regulation or professional standard. Inspections, on the other hand, are governed by Section 104 of the Act and do not involve perceived violations of law. Rather, inspections, the timing of which is mandated by the Act, are designed to review periodically and, where necessary, encourage improvements in, a registered public accounting firm's compliance with the relevant U.S. laws, regulations and professional standards.

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Finally, some commenters asked that the Board ensure that non-U.S. registered public accounting firms are afforded certain rights whenever the Board relies on a non-U.S. authority in the context of investigations or sanctions. This comment reflects a misunderstanding about the nature of the Board's "reliance" on non-U.S. authorities in the context of investigations and sanctions. With regard to investigations, the Board expects that its participation in an investigation when it "relies" on a non-U.S. authority could take one of two forms: the Board will either 1) *decline* to initiate an investigation of its own and simply rely on the fact that a non-U.S. regulator is conducting the investigation pursuant to its own authority; or 2) initiate an investigation to gather information itself but also accept information gathered by a non-U.S. regulator pursuant to its own authority. In both cases, the non-U.S. regulator is acting pursuant to its own authority, not the authority of the PCAOB or the Act. Therefore, the Board cannot ensure that non-U.S. registered public accounting firms being investigated by a home-country regulator acting under the authority of non-U.S. law are afforded certain rights. The Board can ensure only that registered public accounting firms, including non-U.S. registered public accounting firms, are afforded certain rights with respect to the investigation being conducted by the Board acting pursuant to the authority of the Act and the Board's rules.

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In the context of sanctions, the Board's "reliance" (if any) on a sanction imposed by a non-U.S. authority could also take one of two forms: the Board will either 1) *decline* to initiate a disciplinary hearing and impose no sanction of its own, and simply rely on the fact that a non-U.S. authority is sanctioning pursuant to its own authority; or 2) initiate a disciplinary hearing by relying (at least in part) on an investigative record compiled by a non-U.S. regulator that led to a sanction being imposed by that regulator.

In the first scenario, the Board would be "relying" on a sanction imposed by a non-U.S. regulator by not imposing a sanction itself. Because no sanction is being imposed by the Board, there is no need for a Section 105(c) disciplinary proceeding.

In the second scenario, the Board would be using an investigatory record compiled, at least in part, by a non-U.S. regulator. In that case, however, the Board has initiated a disciplinary proceeding pursuant to Section 105(c) and the Board's rules. As a result, before the Board imposes any sanction, the foreign registered public accounting firm will be afforded the same rights under the Act and the Board's rules as if the Board had compiled the record itself.

### **Rule 6001 Assisting Non-U.S. Authorities in Inspections**

PCAOB Rule 6001 provides that the Board may, as it deems appropriate, provide assistance in an inspection of a registered public accounting firm conducted pursuant to the laws and/or regulations of a non-U.S. jurisdiction. The rule also provides that the

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Board may consider the independence and rigor of the non-U.S. system in determining the extent of the Board's assistance.

In response to comments suggesting that the Board adopt a rule reflecting its willingness to assist non-U.S. authorities in their inspection of U.S. firms that audit companies whose securities trade outside the United States, the Board has decided to adopt PCAOB Rule 6001. This rule reflects the Board's previous statements that it is willing to assist in the inspection of U.S. firms that audit or play a substantial role in the audit of public companies in non-U.S. jurisdictions.<sup>3/</sup> Because the interests and needs of non-U.S. regulators will differ across jurisdictions, the Board intends to work out the details of its assistance on the basis of discussions with individual regulators.

Some commenters questioned whether the Act confers authority upon the Board to assist in such inspections. Section 101(c)(5) of the Act grants the Board the authority necessary to assist non-U.S. regulators. Section 101(c)(5) provides that "[t]he Board shall . . . (5) perform such other duties or functions as the Board (or the Commission, by rule or order) determines are necessary or appropriate to promote high professional standards among, and improve the quality of audit services offered by, registered public

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<sup>3/</sup> See PCAOB Release No. 2003-020, Oversight of Non-U.S. Public Accounting Firms (October 28, 2003).

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accounting firms and associated persons thereof, or otherwise to carry out this Act, in order to protect investors, or to further the public interest."

To satisfy the confidentiality requirements under Section 105 of the Act, the Board intends to establish the necessary and appropriate safeguards so that information gathered through its assistance of non-U.S. regulators is maintained separately from the information gathered during a regular or special inspection under Section 104.

Some commenters requested that the Board require, as a condition of its assistance, that the non-U.S. regulator provide a level of confidentiality for information gathered during inspections comparable to that provided by the Act. Because an inspection by a non-U.S. regulator may be conducted pursuant to the authority of non-U.S. law, the Board cannot require or ensure that the non-U.S. regulator will provide a level of confidentiality comparable to that provided by the Act. The level of confidentiality provided by the non-U.S. regulator will be determined by the level allowed under the applicable law of the non-U.S. jurisdiction.

Also consistent with the Board's previous statements regarding cooperation, PCAOB Rule 6001 reflects the Board's intention to provide a level of assistance that is consistent with the Board's determination regarding the non-U.S. oversight system's independence and rigor. In other words, the Board intends to be available to assist in

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the inspection of U.S. public accounting firms where, by virtue of their participation in non-U.S. markets, the U.S. public accounting firm is subject to regulation by a non-U.S. independent public oversight system. However, the Board does not believe it would be appropriate to assist non-U.S. professional associations in their reviews of U.S. public accounting firms.

Because the Board does not believe that local regulators of public accounting firms should impede the efforts of foreign regulators who are taking the necessary steps, as determined by those regulators, to meet their objectives and responsibilities, the Board would not take any steps to hinder a non-U.S. regulator's oversight of a U.S. accounting firm that operates in that regulator's jurisdiction, including obtaining information directly from that firm.

### **Rule 6002 Assisting Non-U.S. Authorities in Investigations**

PCAOB Rule 6002 provides that the Board may, as it deems appropriate, provide assistance in an investigation of a registered public accounting firm conducted pursuant to the laws and/or regulations of a non-U.S. jurisdiction. The rule also provides that the Board may consider the independence and rigor of the non-U.S. system in determining the extent of the Board's assistance.



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With respect to investigations, the Board would assist, to the extent permitted by law in investigations by non-U.S. authorities of U.S. public accounting firms that audit or play a substantial role in the audit of public companies in non-U.S. jurisdictions.