

March, 31, 2003

Office of the Secretary  
PCAOB  
1666 K Street, N.W.  
Washington, D.C. 20006-2803  
USA

**Dear Sir(s):**

**Re: PCAOB Rulemaking Docket Matter No. 001  
Proposal: Registration System For Public Accounting Firms**

We thank you for the opportunity to comment on the above-mentioned proposal.

The German Institut der Wirtschaftsprüfer (IDW), a private organization, and the Wirtschaftsprüferkammer (WPK), a professional self-regulatory body under public law, represent the German audit profession.

In particular, we would like to address the legal conflicts arising from the proposed registration requirements of the PCAOB and the legal and the professional regulations within Germany with regard to client confidentiality, data protection and labor protection. We believe that the PCAOB should consider carefully the matters described below in its deliberations on the adoption of final rules for the registration of foreign public accounting firms.

**I. General Comments**

The adoption of the Sarbanes-Oxley Act is a U.S. reaction to U.S. financial reporting scandals. The Act aims to restore investors' confidence in U.S. capital markets. We share these concerns and support the objectives of the Act. However, the Act is specifically designed for the U.S. legal environment and as such, primarily addresses

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problems and legal issues in a U.S. context. Nevertheless, the provisions of the Sarbanes-Oxley Act are not limited to U.S. accounting firms: they are also applicable to foreign public accounting firms that provide services to SEC registrants or to material affiliates thereof. Consequently, the Sarbanes-Oxley Act of 2002 not only affects large international public accounting firms, but also affects many medium-sized and smaller public accounting firms in Germany and other countries.

Those German public accounting firms affected by the Sarbanes-Oxley Act are subject to professional oversight, including registration requirements, twice (both in Germany and in the U.S.), which may result in conflicts of laws and imposes additional administrative and financial burden on these accounting firms. Presently, Germany like any other EU member states has established effective systems for the approval, registration and the professional oversight of statutory auditors. Both U.S. authorities and the European Commission are in the process of implementing new arrangements in these areas and broadly share the same policy objectives. The new U.S. developments arising from the Sarbanes-Oxley Act are in many ways similar to the initiatives already under way or planned by the European Commission to complete the formation and regulation of the single capital market in Europe.

We believe that capital markets in the U. S. would benefit from the harmonization of standards on a global basis. There is a worldwide need for coordination and reciprocal recognition of the equivalence of quality control and public oversight systems and corporate governance, not on a basis of individual states, but on a mutual basis between the EU and the U.S. and elsewhere. For this reason, the EU and the U.S. should consider what mechanisms could be established to create consistent regulations for global capital markets.

In our opinion, the U.S. should consider recognizing European professional oversight systems as being equivalent to and as effective as that exercised by the PCAOB in the U.S. Equivalence of these systems does not require that the systems are identical. Due to historical and cultural differences and the different legal environment in the U.S. and the EU member states, an appropriate and effective professional oversight system can be organized in various ways.

To this end, the dialogue between U.S. authorities and the European Commission should be continued with a view towards developing principles and criteria upon which equivalence will be accepted by the U.S. The acceptance of the equivalence of the European system implies that the U.S. exempts European public accounting firms from being subject to the Sarbanes-Oxley Act and the oversight exercised by the PCAOB and the corresponding obligations, including registration with the PCAOB.

As long as the dialogue between U.S. authorities and the EU Commission continues with a view towards developing principles and criteria upon which equivalence will be accepted by the U.S., the application of the PCAOB registration requirements for European public accounting firms should be deferred. In any case, the registration deadline for foreign public accounting firms needs to be extended considerably. If the PCAOB nevertheless insists on the registration of foreign public accounting firms in the U.S., due to the legal conflicts described below (section III), European public accounting firms should be exempted from any requirement that may conflict with national law, since these would prevent those firms from an unlimited commitment to cooperate and comply, or secure and enforce compliance with PCAOB requirements.

## **II. Registration deadline**

One of the questions raised in the “Proposal of Registration System for Public Accounting Firms” is whether it is feasible for foreign public accounting firms to register within 180 days of the date of the SEC’s determination that the Board is capable of operating. In addition, the question is asked whether foreign public accounting firms be afforded some longer period (e.g., an additional 90 days) within which to register. In our opinion, the registration deadline proposed by the PCAOB is not feasible – even if the deadline period were to be extended to 270 days – because of the difficult legal issues arising from the registration requirements with regard to foreign public accounting firms. In particular, large quantities of information that cannot be gathered in a short time need to be obtained pursuant to Form 1. For example, Form 1 requires considerable information about certain proceedings involving the applicants’ audit practice that covers not only the applicant, but also employees, owners, partners, principals, shareholders and officers of the applicant. The form requires the disclosure of information about certain proceedings under U.S. criminal or civil law etc. or equivalent proceedings in other jurisdictions. To meet these disclosure requirements, applicants must first determine which legal requirements (laws, regulations, etc.) in Germany are substantially equivalent to those listed in Form 1 Item 5.1 to 5.5. This will require external legal advice and impacts the conditions of fair competition between U.S. and non-U.S. applicants.

The considerable administrative and financial burden borne by foreign public accounting firms subject to the registration requirements of the PCAOB may cause many firms other than the so-called “big four” to consider whether they should withdraw from current engagements or not accept new engagements by which they are or would become subject to the provisions of the Sarbanes-Oxley Act. These circumstances will lead to an increased concentration of audits of publicly listed clients towards the so-called “big four” firms. This does not appear to be an outcome that gov-

ernment authorities in the U.S., including the SEC, desire: Section 701 of the Sarbanes-Oxley Act even contains a provision requiring a study of concentration within the audit market.

Furthermore, German public accounting firms considering an application to register with the PCAOB must determine whether they are permitted under German law to collect the information needed to be gathered to meet the requirements under items 5.1 to 5.5 and to disclose the collected information. Due to existing labor legislation in Germany and legal requirements under the German Constitution (Grundgesetz) with respect to "informationelle Selbstbestimmung" (the requirement that individuals must have the right to determine which information about them and to which purpose it may be used by third parties) and to "Datenschutz" ("privacy": the right to the privacy of information) it is apparent that such disclosures for the previous ten years cannot be made. For further details, see our detailed comments to specific items in Form 1 (section III) below.

It would be necessary to amend German laws or regulations to enable German public accounting firms to register with the U.S. PCAOB, a requirement which cannot be expected to be favored by the German Federal Government. Besides, such amendments are impossible if they violate the constitutional principle of equality. Employees of an audit firm are protected by the same laws applicable to any other employee.

We would also like to point out that any legal prohibition on the collection and disclosure of information by a German public accounting firm also leads to the legal prohibition of the disclosure or examination of such information as part of an inspection program.

An additional matter is that, under German law, the election of the statutory auditor of the financial statements by the shareholders and the subsequent appointment and engagement of that auditor by the supervisory board are required to take place before the end of the financial year being audited. For example, for publicly listed companies (German stock corporations) the statutory auditor of the annual financial statements for the year ended December 31, 2003 is generally elected and appointed within the first six months of the year 2003 but it may not be clear at that time whether this auditor will meet the registration requirements of the PCAOB later in 2003. Until June 2003 the auditor can not yet be registered and does, therefore, not qualify for an audit of an issuer. The duly elected and appointed statutory auditor must perform the audit and may only be permitted to withdraw from the audit in exceptional circumstances that are stringently defined by law. A duly elected and appointed statutory auditor that ceases to meet U.S. PCAOB registration requirements would remain statutory auditor under German law.

The issues mentioned above are only examples to demonstrate the amount of time and care German public accounting firms will need to devote on the clarification of legal issues and the collection of information needed to meet registration requirements of the U.S. PCAOB. Consequently, we believe that the registration deadline for foreign public accounting firms needs to be extended considerably. We propose that the deadline be extended to at least one year from the date that the Commission determines the Board to be capable of operating. This would ensure that the prerequisites for registration are substantially established for audits of annual financial statements for the year ended December 31, 2004.

### **III. Detailed Comments to Specific Items in Form 1**

As mentioned above, registration of German public accounting firms may conflict with national law. This might therefore prevent those firms from an unlimited commitment to cooperate and comply, or secure and enforce compliance with PCAOB requirements as claimed in Part VIII of Form 1.

At present it is not possible to describe in detail all legal implications for German public accounting firms resulting from registration with the PCAOB. Due to the complexity of these issues, which are affected by several areas of law, the legal implications of the PCAOB registration requirements need further research and consultation with German authorities, e.g. the Federal Ministries of Justice and Economic Affairs.

However, we would like to give some examples of possible implications resulting from national law to emphasize the complexity of these issues.

1. Part V of Form 1 calls for information about criminal, civil, administrative or disciplinary proceedings against the applicant or its associated persons. Associated persons include all individuals employed with the applicant that are involved in performing an audit engagement. Item 5.1 to 5.5 would require applicants to request such information from their employees.

In Germany the rights of employees are protected extensively by Federal labor law and the judiciary. Unlike other branches of civil law, fundamental constitutional principles are applied directly, in particular, the right to privacy under Article 2, paragraph 1 in conjunction with Article 1, paragraph 1 of the German Constitution (*Grundgesetz*).

This right to privacy limits the employers' right to demand specific information from their employees. Judicial decisions in this respect declare that, in general, an employer is not entitled to request information from employees about previous criminal convictions.

The only exception is that the employer may request information from employees about criminal convictions that may effect an employee's personal suitability for a particular occupation. Nevertheless, the use of this information is restricted to the relationship between employer and employee and must not be disclosed to third parties as regulated in the Federal Data Protection Act (*Bundesdatenschutzgesetz*). The result is that information related to criminal convictions may only be disclosed to third parties with the employee's written permission. To obtain this permission the employer has to inform the employee personally about reasons for requesting, treatment and use of the data. The employee has the right to withdraw his or her permission at any time.

Even if the permission is given, pursuant to Article 4b of the Federal Data Protection Act, data shall not be transferred outside the European Union unless the foreign addressee guarantees confidential treatment and this is approved by German authorities in charge. This national regulation is based on European legislation on data protection (Directive 95/46/EC).

Consequently, even if an applicant to the PCAOB requests information related to items 5.1 to 5.5 of Form 1 from an employee, that applicant cannot disclose the information to the PCAOB without the permission of the employee and without clearing further administrative hurdles. The employer has no right to force the employees' permission. Furthermore, the employee's representatives may – on the basis of the Federal Works Constitution Act (*Betriebsverfassungsgesetz*) – prevent the employer from asking for general permission to disclose information related to items 5.1 to 5.5 of Form 1. Furthermore, any action taken by the applicant to obtain consent from the employees would lead to a mandatory involvement of the workers' council. Such involvement follows detailed – and time-consuming – procedures. The employer is not entitled to give instructions to the workers' council.

2. Another problem might result from the 10 year period concerning the information requested under Part V of Form 1.

Criminal convictions are listed in a Federal Register (*Bundeszentralregister*) maintained by the Federal Public Prosecutor's Office. The register is not open to the public. Information can be requested only by public prosecutors, courts, authorities and the convicts themselves. Entries to the register are deleted after a certain period of time, depending on the sentence imposed and the criminal offence. In general, entries are deleted after 5 years, in minor cases after 3 years. If deleted the convict is considered as and can claim to be *not previously convicted*. Consequently, an applicant can only request information related to criminal convictions within the last 3 or 5 years.

3. Furthermore, the information required under items 5.1 to 5.5 is not limited to issuers, but may include information related to retired persons, other clients or third parties which are neither issuers nor clients of the applicant.

This may contravene applicants' legal duty of confidentiality as prescribed by *inter alia*, Article 43, paragraph 1 of the German Public Accountants Act (*Wirtschaftsprüferordnung*) and Article 323, paragraph 1 of the German Commercial Code (*Handelsgesetzbuch*). Any breach of this legal confidentiality requirement may result in sanctions being imposed by professional disciplinary proceedings either by the WPK or a special disciplinary court established at the Berlin District Court, depending on the severity of the breach. In addition, any such breach may result in fines or imprisonment under Article 203 of the German Criminal Code (*Strafgesetzbuch*), unless the particular client has given permission to the accountant to disclose all, or specific information relating to client matters.

In general, such permission would be received from issuers. However, before giving permission, even issuers need to consider privacy and data protection issues with respect to those individuals within the company that may be affected. The same applies to other clients that are not issuers. Considering these legal and administrative obstacles, in many cases particularly the clients that are not issuers would probably not give such permission since it might be too burdensome.

4. As mentioned under II.3, disclosure of non-issuer client or third party related information under Part V of Form 1 might conflict with an applicant's legal requirement to maintain strict confidentiality. Hence, German applicants giving a statement as requested under Part VIII of Form 1 cannot guarantee the enforcement of the requirements of the PCAOB in all respects (e.g., when an employee refuses his or her permission to disclose criminal records, see (1.)). There is no legal right by which the applicant may demand the consent to any disclosure. If an applicant were to fulfil such requirements without the permission of the employees, retired persons, clients or third parties, the applicant would face disciplinary or criminal proceedings for breaching his or her legal obligations.
5. All of these legal problems also apply to inspections and investigations pursuant to the Sarbanes-Oxley Act. For example, due to the German privacy and data protection regime, the PCAOB may not have access to certain data. Besides, it is uncertain whether German or European authorities will allow the PCAOB to act on German territory without their agreement.

These examples illustrate only a few of the legal and practical obstacles to the registration of German public accounting firms. Further clarification of these issues and other potential issues cannot be provided within the proposed deadline period.

Yours truly,

Dr. Veidt

Prof. Dr. Naumann

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