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By

Head of Delegation

April 11, 2003

Mr. Charles M Niemeier
Chairman of the PCAOB
1666 K Street, N.W
Washington DC 20006-2803

Dear Mr Niemeier

Attached please find a copy of a letter from Commissioner Bolkestein, dated 11th April 2003, on the PCAOB's, draft rules on the registration and oversight of foreign audit firms.

The original letter will follow by mail.

With the assurances of our highest consideration.

Gérard Depayre
Charge d'affaires a.i.

Enclosure - 2

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Frits Bolkestein
Member of the European Commission

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Brussels, 11 04 2003

Dear Mr. Niemeier,

At the request of the European Union's Finance Ministers, I am writing to you on behalf of the European Union (EU), concerning the Public Company Accounting Oversight Board's (PCAOB) forthcoming rules on foreign auditor registration and oversight

Whilst the European Union supports the broad aims of the Sarbanes-Oxley Act, we are very concerned about the draft PCAOB rules, discussed recently in Washington DC at the March 31 PCAOB Roundtable and due to be finalised soon. These draft rules and the registration requirements they contain will cause major difficulties for European audit firms

We have 4 major concerns.

1. Since the mid-1980's, on the basis of a European Directive, the European Union's Member States have established effective, equivalent registration requirements in all our 15 Member States for all EU auditors. The public oversight systems in which these registration requirements are embedded may take different forms due to the different legal traditions of our Member States, but they exist, and work. The PCAOB proposals therefore add an unnecessary, expensive second layer of regulatory control for those EU Audit firms that will be subject to registration with the PCAOB We consider that the best way forward in this area is to work towards an effective and efficient approach based on mutual recognition and equivalence. If we cannot move forward on this basis, it will be difficult to avoid calls for reciprocity and requirements whereby U.S audit firms would have to register with all our Member States (15 today, 25 soon with the enlargement of the EU), and be subject, also, to EU oversight mechanisms.

M. Charles M. Niemeier
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2 The present PCAOB draft registration rules will cause serious conflicts of law with existing EU and national laws. In effect, mandating EU audit firms to register with the PCAOB in the manner proposed in order to provide audit services to EU and other companies listed in the United States and their subsidiaries will cause these audit firms to infringe EU and national laws. I enclose in annex a short memorandum highlighting some examples of the legal conflicts which will arise.

3 The PCAOB proposals will tend to concentrate even further the market for audit services, globally and in the EU. Small EU audit firms, with few listed clients in the US may well decide not to register with the PCAOB because of the heavy costs and implications involved. In any event the relative costs for European firms will be higher than for local US firms.

4 Finally, the PCAOB rules, to be adopted formally by the SEC, must fully respect accepted principles of international law. Moreover, the PCAOB should be aware that EU policy making, as in the US, is in the process of change. For example, the European Commission will be tabling a significant new audit and corporate governance policy in the next few months tailored to the EU's legal and cultural environment. In many Member States important policy changes in these areas are also underway building on the existing solid legal basis.

For all these reasons, we request full exemption for EU audit firms from the rules on registration under section 106 (c) of the Sarbanes-Oxley Act as we suggested in our testimony to the Roundtable. I firmly believe that the right approach is to accept a moratorium (say 1 year) for both registration and oversight and to discuss openly with all international regulators an acceptable and efficient approach based on mutual recognition and equivalence. We would be willing to work constructively and intensively in that direction.

If we are not able to find a common approach to these highly sensitive matters, I see a danger of additional tension which might have a negative impact on confidence and the performance of financial markets which we can ill afford at the moment.

I would be most grateful for an early response to this letter which I underline, contains issues of significant political importance for the European Union.

I am sending this letter in parallel to Treasury Secretary Snow, Senator Shelby, Senator Sarbanes, Representative Oxley, Representative Frank, US Securities and Exchange Commission, SEC Chairman Donaldson and copying it to all Ministers of Finance in the European Union.

Yours sincerely,

Frits Bolkestein

MEMORANDUM ON CONFLICTS OF EUROPEAN UNION AND NATIONAL LAW WITH DRAFT PCAOB RULES FOR FOREIGN AUDIT FIRM REGISTRATION

1. Introduction

Ministers of Finance of all 15 EU Member States decided unanimously at their meeting on 5 April in Athens to request a full exemption for EU audit firms from the PCAOB audit registration process. With regard to foreign audit firms – unlike US audit firms - , the PCAOB has been granted a specific exemptive authority under section 106(c) of the Sarbanes-Oxley Act to enable such an outcome

The EU Finance Ministers have also requested the European Commission to provide you with a Memorandum demonstrating in more detail the national and EU legal conflicts EU audit firms would face if they are required to register with the PCAOB.

This Memorandum on legal conflicts is complementary to the European Commission's comment letter already sent to the PCAOB on 28 March and our comments made at the PCAOB round table meeting on the registration of foreign audit firms on 31 March In our letter and at the Roundtable, the European Commission requested an exemption for the registration of any EU audit firm because we believe the PCAOB's proposal is:

- ineffective (e.g. due to legal impediments to transfer data to the PCAOB and access to audit working papers);
- unnecessary (because of existing European legislation on the registration and the existence legally underpinned systems of public oversight in all Member States for many years);
- disproportionate in that it involves significant costs of registration for EU audit firms with a relatively small number of US issuers;
- likely to cause distortions of the market for audit services and further concentration of audit services provided by the large audit firms (because the relative cost will be too high for audit firms performing audit work for only one US issuer);
- prejudicial to future EU policy making on audit issues

A complete inventory of possible legal conflicts with foreign jurisdictions requires sufficient time which unfortunately is not available due to the time constraints under which the PCAOB is operating. The following presentation of legal conflicts is based on a first preliminary analysis of these issues at EU and Member State level. It presents a range of significant legal issues accompanied by specific examples from Member States. Further analysis may result in additional areas where legal conflicts may arise. Avoidance of such conflicts can only be achieved by lifting the registration requirement from EU

2. Legal Conflicts in relation to registration with the PCAOB

The PCAOB should acknowledge that that there are well recognised limits on the outreach of US law and non-US law. One country's law can only compel a person in another country to perform an Act "to the extent permitted by the law of his home jurisdiction" (Restatement 3rd on Foreign Relations Law of the United States).

Among the main identified legal conflicts are:

2.1. EU-wide data protection issues

Legal conflicts arise at Member State and at the level of European Union law. A prominent example is Directive 95/46/EC dealing with data protection. This European Directive is in force since 1998 and has been implemented in all fifteen Member States

Much of the information requested in the proposed PCAOB registration exercise, under the data protection Directive, is considered as "personal data" or even "sensitive personal data". According to this Directive, data subjects enjoy certain rights, and data controllers have certain obligations. Data can only be processed for legitimate and specified purpose. This would, for example, require that specific and informed consent should be given by each "accountant" of the audit firm prior to the transmission of his data in the registration application. More importantly, the Directive prohibits transfers of personal data to countries outside the European Economic Area which do not provide adequate data protection in accordance with the Directive. The US is such a country. The European Commission has approved a data flow international arrangement with the US government called, the safe harbour, to facilitate compliance with the Directive. If adhered to, it would also allow the transfer of the data to the PCAOB. However, the present safe harbour arrangement is operated under the FTC (Federal Trade Commission) and does not cover the financial services sector. There is currently no safe harbour agreement on financial services. It is therefore, at present, legally impossible for EU audit firms to submit a large part of the information requested for the registration to the US PCAOB.

This general data protection requirement would, for example, prevent EU audit firms from providing information with regard to

- data on employees including the person's name or social security number
- information relating to criminal, civil or administrative actions or disciplinary proceedings pending
- information relating to non-SEC audit clients

2.2. Other legal obstacles with regard to data transfer to the PCAOB

At the level of Member States' laws there are legal conflicts that would prevent EU audit firms from providing the PCAOB with certain information. For example:

2.2.1. Employees; legal proceedings

Two main areas of registration requirement of the proposed PCAOB rules concern data on employees and associates and, partly linked, information on legal proceedings. Some prominent examples from Member States' legislation show the difficulties involved:

In the **United Kingdom**, the employment relationship results in an implied duty of confidence between employer and the employee. Information retained by an employer may be regarded as confidential to the employee Disclosing such information would breach confidence and the implied term of trust and confidence.

Even if consent is obtained, employees may have the right to refuse or to testify or disclose documents on the grounds of the privilege of self incrimination. Under English law the principle of privilege against self-incrimination provides that a person shall not be coerced by the exercise of state power to convict himself/herself of a crime or expose himself/herself to any criminal penalty.

Any sanction imposed on an employee must be proportionate to the employee's act or omission. Therefore, if an accounting firm dismissed an employee e.g. following an order from the PCAOB or for refusing to disclose documents an employment tribunal could rule that the dismissal was a disproportionate sanction and unfair

In **Denmark**, secrecy laws do not allow the audit firms to provide information on their employees or associated persons to third parties

Finland imposes duty of care regarding the processing of personal data (section 5 of the Finnish data privacy act). This serves the protection of the data subject's private life and other basic rights. Transfer of personal data must be in accordance with the Act. The processing of sensitive data is prohibited (especially in relation to criminal sanctions, Section 11).

In **Germany** the rights of employees are protected extensively by Federal labour law and the judiciary. Unlike other branches of civil law, fundamental constitutional principles are applied directly This comprises in particular the right to privacy due to Article 2, paragraph 1 to be read in connection with Article 1, paragraph 1 of the German Constitution.

The right to privacy limits the employer's right to demand specific information from his employees. As stipulated by the courts, in general the employer has no right to request information concerning previous criminal convictions of his employees

Only by way of exception, the employer may request information concerning criminal convictions that may affect the employee's personal qualification for the occupation concerned. However, this information can only be used for the employer's decisions with respect to the employer-employee relationship. The information cannot be disclosed to third parties. There is no right to force the employee's permission. Besides, the employee's representatives may - because of the Federal Works Council Constitution Act - hinder the employer from asking for a general permission on disclosing information

In **Belgium**, professional secrecy rules prohibit the signing of a statement to comply with any request for testimony. Professional secrecy has to be guaranteed by the persons employed by the auditor. Another specific problem concerns the disclosure of information on certain proceedings concerning criminal actions in connection with audit reports. Pending criminal investigations are not public. Only if the case has been brought to court (full) information becomes available for the defendant and other parties. In civil actions the general rules on professional secrecy have to be taken into account.

2.2.2. Audit client information

A further problematic issue is the revelation of data concerning audit clients. This is especially valid with regard to information on non-SEC audit clients For example:

In **Denmark**, secrecy rules cover all information regarding audit or consulting clients. Accordingly, Danish audit firms cannot give information regarding clients, unless clients have consented to this

The **Swedish** Auditors Act (paragraphs 26 and 28) prevents Swedish auditors to provide information on clients to parties other than the supervisory boards of accountants

In **Germany**, the revelation of information related to other clients or third parties being not even clients might contravene the applicant's duty of secrecy, as set out, inter alia, in Article 43, paragraph 1 of the German Public Accountants Act and Article 323, paragraph 1 of the German Commercial Code. Any breach may be sanctioned in professional disciplinary proceedings due to the severity either by the Chamber of Public Accountants or a special disciplinary Court established at the Berlin District Court In addition, any breach might be sentenced by fine or imprisonment under Article 203 of the German Criminal Code, unless the respective client has given permission to the accountant to disclose all, or specific parts, of information on the client's matters.

3. Access to audit working papers and documents of the audit client

A key area of EU concern is access to audit working papers. The draft PCAOB rules on registration of foreign auditors require the foreign auditor to give written consent to hand over his working papers to the PCAOB. This conflicts with specific professional secrecy laws. In many Member States the auditor is only allowed to provide audit working papers to Courts or to defined inspection authorities, a restriction that cannot be waived by the audit client. In these cases would be illegal for the audit firm to give consent to the access of "documents" as required by item 8.1 of Form 1. Moreover, in case audit working papers, or any other client document, would contain personal data, they could not be transferred to the PCAOB due to the EU wide regime on data- protection.

In **France**, Article L225-240 of the French Commercial Code provides that auditors shall be bound by professional secrecy as regards all acts, events and information of which they may have become aware in the course of their duties. Decree 69-810 expressly states that only French authorities are granted access to audit files

In **Denmark**, unauthorised handing over of audit working papers of clients represents a criminal offence. **Belgium** has a similar requirement (article 458 Belgian Criminal Code).

Finland also protects information obtained from clients by professional secrecy obligations laid down in Section 25 of the Finnish Auditing Act

4. PCAOB investigations and inspections

Whilst the draft PCAOB registration rule does not directly address PCAOB inspections and investigations, questions were posed at the Roundtable by the PCAOB to explore the possibility of PCAOB directly inspecting EU audit firms. The European Commission and all fifteen EU Member States are very concerned about this and clearly reject the idea of SEC/PCAOB investigations or inspections on EU territory. We already addressed similar concerns in the European Commission s comment letter to the SEC on SEC proposed rules on Retention of Records Relevant to Audits and Reviews (*Release No.* 34-46869; IC-25830; *File No* S7-46-02)

Conducting such inspection activities on foreign territory raises questions of international law, in particular compatibility with general principles concerning jurisdiction and sovereignty, and would not be permitted in virtually all Member States

It is obvious that effective inspections require access to audit working papers. In addition to the cases mentioned under the previous point, secrecy rules in **Portugal** do not allow access to documents obtained in the course of an audit to third parties. **Spain** allows access to audit working paper only under conditions laid down in law (Article 14 of the law on auditing) which will not permit PCAOB/SEC staff access.

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