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Public Company Accounting Oversight Board
(PCAOB)
Office of the Secretary
1666 K Street, N.W.,
Washington, DC 20006
USA

By e-mail: comments@pcaobus.org

February 2, 2009
541/584

Dear Sir / Madam

PCAOB Rulemaking Docket Matter No. 027 – Rule Amendments Concerning the Timing of Certain Inspections of Non-U.S. Firms and Other Issues Relating to Inspections of Non-U.S. Firms

The Institut der Wirtschaftsprüfer [Institute of German Public Auditors] (IDW) is pleased to have the opportunity to comment on the above-mentioned PCAOB Rulemaking Docket Matter concerning inspections of non-U.S. firms. We wish to comment on this issue, since a number of our members, who are registered with the PCAOB, are likely to be directly affected by the proposals.

We view the proposals in general as a step in the right direction, and welcome the fact that, in taking this action, the Board concedes that there is a need for more time to address certain problems it is currently facing in its inspection program, including that of legal conflicts. As at the date of this letter there are certain conflicts between the relevant German and U.S. laws, which prevent German firms from fully cooperating with the PCAOB. Indeed, adequate time is needed if this situation is to be resolved in a satisfactory manner, preferably by means of cooperation between oversight authorities in accordance with the concept of mutual reliance. We would like to stress that, in our opinion, it is neither justifiable nor necessary to penalize German audit firms in any way in the meantime.

Whilst we appreciate the position in which the PCAOB is currently placed, given the special issues posed in respect of non-U.S. firms, we do not support all the actions proposed by the PCAOB at this stage because certain initiatives on the

part of other parties, including counterpart oversight authorities that are currently in progress may require further time for completion. For example, we note that in the European Union discussion of practicalities relating to Article 47 of the 8th EU Directive[1], which deals with cooperation with competent authorities from third countries, will be continuing into early 2009. We realize that the PCAOB has stated in the Release that it remains hopeful that ongoing discussions with certain local authorities will result in the resolution of outstanding issues, but suggest the Board may, in some cases, also need to provide further leeway, should this not prove to be the case in the timeframe envisaged.

We also share the PCAOB's view that there is long-term value in accepting a delay in inspections to continue working toward cooperative arrangements and agree that this is indeed preferable to precipitating legal disputes involving conflicts between U.S. and non-U.S. law. However, as mentioned above, we are not convinced that the envisaged length of time for the postponement of overdue initial inspections will be adequate in every case to allow measures to be established to satisfactorily address the problems posed by legal conflicts. As opposed to forging ahead with its own program of inspections and thus forcing certain individual firms to either violate local law or risk being sanctioned by the PCAOB, we suggest the Board consider whether it could place some degree of reliance on inspections carried out by a foreign oversight authority possibly with disclosure of such fact as an interim measure whilst the Board completes its own negotiations with, or evaluation of, the respective authority, which as we discuss below, should be carried out with a view to achieving full reliance within an agreement on mutual recognition wherever possible. We believe that such interim measures would be in the wider public interest and the protection of investors. Furthermore, as we explain in more detail below, we believe that certain other aspects of the proposals are not in the public interest.

In this letter, we firstly discuss these general concerns, and then comment on specific details of the proposals put forward in the above-mentioned PCAOB Rulemaking Docket Matter. We also discuss certain further aspects of this issue which did not feature in the discussion in the above-mentioned Release, and include suggest possible courses of action related thereto.

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1 DIRECTIVE 2006/43/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/ 660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC

General Matters of Concern

Coordination and Cooperation with Foreign Oversight Authorities

We are concerned that the above-mentioned PCAOB Rulemaking Docket Matter refers only to initial inspections performed either jointly with counterpart foreign oversight authorities or solely by PCAOB inspectors, but does not refer at all to the possibility of the PCAOB placing reliance on the work of counterpart foreign oversight authorities, despite the fact that the PCAOB itself recognizes that this may be one way in which legal conflicts may be addressed. Since the issue of reliance on the work of counterpart foreign oversight authorities is highly relevant to any consideration of the PCAOB's inspections program as a whole, we do not believe the timing of certain inspections can be dealt with without considering the issue of such reliance.

We infer from remarks on page 5 et seq. of the Release that whilst the Board confirms its willingness to coordinate with foreign oversight authorities, it may not yet be actively seeking to place full reliance on inspections performed by foreign oversight authorities. Indeed, to date the PCAOB has apparently made little or no discernable progress towards mutual recognition based on full reliance, since the Release states that all of the 123 non-U.S. inspections completed to date have involved either joint inspections (57) or PCAOB-only inspections (66).

In a letter to the PCAOB dated 29 February 2008, we had commented on the Proposed Policy Statement concerning the PCAOB's potential reliance on inspection work performed by foreign oversight authorities. In particular, we had urged the PCAOB to undertake a constructive evaluation of individual oversight systems taken as a whole, including due consideration of the environment in which they operate, with the ultimate view to allowing the PCAOB to place full reliance on the foreign oversight authority once the Board is satisfied as to the effectiveness of the respective oversight system. This would, in our opinion, facilitate the establishment of cooperative arrangements with the relevant counterpart oversight authorities such that joint inspections would not be a permanent feature, but would be replaced by consultation on work programs and notification of subsequent results and so forth following initial assessment of the individual country's system.

While we appreciate that, as stated on page 6 of the Release, the Board may need to expend a substantial effort in evaluating a particular non-U.S. system or trying to resolve potential conflicts of interest, we remain of the opinion that mutual recognition, where this can reasonably be achieved, would involve a "one-

off" effort, which, in the long term, is in the best interests of investors in the relevant capital markets, foreign oversight authorities and the PCAOB itself. Accordingly, we would like to once again urge the PCAOB to take appropriate steps and also to allow sufficient time to seek mutual recognition with its foreign counterparts to the full extent possible.

In this context, we would like to remind the Board that we had also commented upon the fact that in the Proposed Policy Statement the PCAOB itself had not given sufficient regard to, for example, the significant factors the EU Statutory Audit Directive (8th EU Directive) specifies as prerequisites for cooperation between auditor oversight authorities of EU Member States with the competent authorities from other countries. In our opinion, this issue also needs to be addressed as a part of the "solution", at least as far as Europe is concerned. In a European context, the relevant article of the Directive states that the European Commission would need to be satisfied that the PCAOB is able to treat certain information as confidential before it can be made available.

Legal Conflicts

The satisfactory resolution of conflicts between U.S. and non-U.S. law is not only in the interests of individual firms affected and the PCAOB, but also in the public interest, both in the U.S. and in the individual foreign jurisdiction affected, because public accounting firms must fully uphold the laws valid in the jurisdiction in which they operate at all times – and be seen so to do. If firms were to be coerced or forced by the PCAOB in its capacity as an auditor oversight authority into violating "selected" aspects of their home-country law public confidence in their integrity, that of oversight authorities and indeed the integrity of the law itself would be severely damaged. It is for the respective legislator(s) to amend laws to the extent necessary to facilitate cross-border oversight measures; not for individual firms to [or to be forced to] violate their home-country law, irrespective of how valid the reason may be to individual parties. The Act, and in particular Sec. 104(d)(1) of that Act, possibly did not foresee the extent of the legal conflicts the PCAOB would face, neither were home country laws designed to accommodate PCAOB inspections. Reaching satisfactory solutions requires much deliberation, consultation and above all cannot be achieved hastily. In this context we would also like to point out that Sec.106 of the Act does provide a means by which exemptions may be made in some cases. We note with concern that this possibility has not been mentioned at all in the Release, as this omission leads us to the conclusion that the Board has either not even countenanced the idea that exceptions of any sort could be made, or, alternatively that

the Board has considered and dismissed this idea without disclosing this fact in this or other public Releases, thus precluding public discussion. In our opinion, this is an issue worthy of further discussion in the public forum, not only within the confines of the PCAOB itself.

We cannot support the PCAOB's implied contention that it may be necessary for non-U.S. audit firms to be forced to either deny their cooperation or comply with requests of the PCAOB in violation of their local law, simply because adequate constructs have not (yet) been established to address legal conflicts. It is untenable to use individual non-U.S. audit firms as what would amount to "pawns" to highlight those inconsistencies in lawmaking that become apparent in cross border situations. The individual non-U.S. firms affected find themselves in this situation through no fault of their own, but, at the same time, are not in a position to influence legislators to hasten the resolution of such legal conflicts. As we have stated above, before firms are placed in this situation, reasonable but adequate time needs to be allowed for the PCAOB to continue negotiations with its foreign counterparts and, where appropriate, with national legislators or transnational legislative bodies such as the European Commission in order to arrive at solutions that are acceptable to all parties affected. There may also be a need to devise an alternative measure in the meantime, perhaps along the lines as we have suggested above. We question whether the Board might not avail itself of the possibility of exempting firms or classes of firms from specified provisions of the Act or the Rules of the Board, pursuant to Sec.106 (c) of the Act in this regard.

Specific Comments on PCAOB's Proposals

Adoption of an Amendment to Rule 4003 Extending the Deadline for Certain 2008 Inspections – Addition of Rule 4003(f)

We support the Board's amendment to Rule 4003 to allow the Board to postpone the inspections of those foreign registered public accounting firms that are currently required to be conducted before the end of 2008 for up to one year as a first, but not necessarily final step.

This notwithstanding, in our view, the statement on page 9 that the Board does not intend to make any further adjustments to the inspection frequency requirements for initial inspections that were due to have been performed by the end of 2008 may be premature. We are extremely concerned as to the stance taken by the PCAOB in respect of a reluctance to cooperate on the part of an *individual* firm which finds itself in the situation of not yet having undergone an initial in-

spection involving the PCAOB which has become overdue, should the issue of legal conflicts the firm is faced with not have been satisfactorily resolved within the extended timeframe. In any case, we do not understand the rationale for the PCAOB's belief that all initial inspections due to have been performed by the end of 2008 should be postponed by only one year, whereas initial inspections otherwise due by the end of 2009 may, in some cases, be postponed further – i.e., for up to 3 years. We note that, in proposing the 3 year extension, the Board makes a distinction between firms headquartered in countries in which no foreign registered public accounting firm that the Board inspected is headquartered and those where this is not the case. This distinction may be equally appropriate in respect of initial inspections due to have been performed by the end of 2008. As a minimum, we suggest the PCAOB consider whether a staggered approach such as that proposed for the latter inspections' postponement might be equally appropriate for those initial inspections due to have been performed by the end of 2008.

Proposed Amendment to Rule 4003 Extending the Deadline for Certain Inspections Otherwise Due to be Performed in 2009– Addition of Rule 4003(g)

We generally support the proposal to extend, for a further three years, the period in which initial inspections of the 70 certain non-U.S. firms otherwise due by the end of 2009 shall be performed. As discussed above, we believe that more time will be needed for, among other things, the PCAOB to finalize individual agreements relating to the implementation of PCAOB Rule 4012 together with its foreign counterparts.

Transparency Concerning Delayed Inspections

A completed inspection report alone can provide truly useful information to an investor. We doubt whether publishing the identity of firms that have not been inspected within the timeframe would provide investors with meaningful information. In particular, we are concerned if the information is made public in the manner proposed in the Release, investors and other interested parties may inappropriately attach negative connotations to that information. Indeed, such publication may unintentionally lead to a certain amount of "stigmatism" of the individual firms affected. For example, a non-U.S. firm servicing a U.S. issuer(s) may be "un-inspected" either because no inspection is yet due, in which case the public would not be specifically informed that there has yet to be an inspection; or the inspection has become overdue and the public would not be so informed. The resultant "negative publicity" could have an unwanted impact on

auditor selection, should public perception lead to the discrimination of firms falling into the latter category.

Obligations of Registered Firms

Notwithstanding the fact that firms registered with the PCAOB are required to cooperate in an inspection, as we have reasoned above, we believe it is in the public interest that individual firms in a particular country have legal certainty that they will not violate home country law in making their audit documentation available to the PCAOB. As the Board observes, firms may, in the absence of this legal certainty, be reluctant to provide requested information to the PCAOB.

We are concerned that the statement on page 15: "The Board cannot, however, let the prospect of such refusals dictate delays in the Board's efforts to conduct inspections." and the text in footnote 35: "The Board does not view non-U.S. legal restrictions or the sovereignty concerns of local authorities as a sufficient defense in a Board disciplinary proceeding instituted under section 105(c) of the Act for failing or refusing to provide information requested in an inspection." do not take account of the fact that there may be firms, that through no fault of their own, genuinely find themselves in a situation in which they need to obtain legal certainty before making audit documentation available to the PCAOB. These firms are not being willfully uncooperative and, on this basis, we do not agree that their registration with the Board should necessarily be jeopardized. Indeed, the intent underlying these two statements appears, to us, to be in conflict with the statement on page 16 in which the Board states that "consideration of any actual noncooperation case will be based on the facts of the case".

As we have explained above, we find it unacceptable that the PCAOB should attempt to force individual firms to violate or potentially violate their home-country law, irrespective of how valid the reason may be to individual parties. Rather, we suggest that the PCAOB needs to take appropriate but differing measures to deal, on the one hand, with those outright refusals to cooperate that section 102(b)(3)(B) of the Act was clearly designed to guard against and, on the other, with reasoned delays that do not reflect any intent not to cooperate on the part of the firm. In the case of the latter, as we have explained above, we do not believe it is in the public interest for the PCAOB to request information at a point in time where the firm is not in a position to make that information available, inevitably forcing sanctions.

In addition, the PCAOB might like to note that in respect of sovereignty concerns Article 47 of the EU 8th Directive specifically provides that "…the request from a competent authority of a third country for audit working papers or other documents held by a statutory auditor or audit firm can be refused where the

provision of those working papers or documents would adversely affect the sovereignty, security or public order of the Community or of the requested Member State ….". This is in direct conflict to the text of PCAOB Release's footnote 35 quoted above.

Sanctions Resulting from Noncooperation

We note that on page 16 of the Release, the Board invites public comment generally on whether and how the fact of a non-U.S. legal restriction or sovereignty concern should be factored into the Board's consideration of the appropriate sanction to impose for a violation of Rule 4006.

In our opinion, sanctions as foreseen by the Act, including deregistration as a last resort, may be appropriate in some, but not necessarily all circumstances. We therefore agree with the spirit behind most of the proposed actions. However, as we have argued above, forcing a non-U.S. firm to chose between denying PCAOB inspectors access to audit documentation, thus requiring the PCAOB to instigate sanctions for a violation of PCAOB Rule 4006, or alternatively violating its home-country law, and thus occasioning sanction in the country the firm is headquartered, is undesirable, and would furthermore, result in sanctions that were to all intents and purposes "underserved" from the viewpoint of an individual firm so sanctioned. In our view such ultimate sanctions should be reserved for cases of willful non-cooperation. Indeed, we have argued above that postponing an inspection to allow legal uncertainties to be clarified, provided there is reason to believe that such clarification will be forthcoming in the near future, is a far more appropriate course of action than requesting full cooperation when that cooperation on the part of an individual firm cannot be immediately forthcoming. In such circumstances, in our opinion, delaying an inspection is preferable as it may well obviate the need for the PCAOB to impose sanctions at all. In any case, sanctions involving revocation of a firm's registration with the Board will not be appropriate in all circumstances. We would also like to remind the Board that many non-U.S. firms registering with the Board initially did not do so entirely of their own volition, rather they were placed in the situation where having accepted an audit engagement they were subsequently required to register with the PCAOB. Given these circumstances the act of registration did not reflect a willing consent on the part of the German firms, who at that time, being aware of the legal conflicts involved did not confirmsuch consent originally. Sanctions involving the revocation of a firm's registration, therefore need to be viewed as course of last resort.

Indeed, in many cases these very non-U.S. firms are the only auditors empowered by home country law to perform statutory audits of the companies concerned, such that these firms would also be best placed to perform any audit work on a significant subsidiary of a U.S. parent company to the extent that they are not also the principal auditor. Revoking registration of such firms would mean a significant duplication of audit work, assuming indeed it were even practicable from a legal perspective for firms from a foreign jurisdiction, including the U.S., to perform the necessary audit work in respect of an U.S. issuer previously performed by a deregistered non-U.S. firm. Clearly such doubling of efforts and associated costs should be avoided whenever possible. Furthermore, when the non-U.S. firm is also the principal auditor for a foreign company or group listed in the U.S., certainly in Germany, and we believe in most countries, statutory audits could not be performed by firms other than those licensed in the particular country; thus there could be no audit performed to satisfy U.S. requirements if those firms were not authorized. Clearly, forcing such a situation is undesirable.

Transparency of Noncooperation in the Public Interest

We refer to our comments above in respect of the proposal to inform the public as to the inspections carried out and also as to those not performed on schedule as these comments apply equally to a group audit situation. We do not believe that information such as that proposed on page 17 should be placed within the auditor's report:. As we have suggested above, additional information about inspections undertaken by the home-country oversight authority in the absence of initial inspections by the PCAOB might be useful to investors.

We are concerned that in proposing that a principal auditor collect and present the information outlined in the third and fourth bullet points on page 17, the PCAOB would be requiring principal auditors to assume certain duties that amount, albeit in a limited way, to an oversight function and to make public the results thereof. In this context, we note that auditing standards generally require principal auditors to be satisfied that the standard of work performed by other auditors, for example in respect of a subsidiary company, is of appropriate quality for the purpose of a group audit; this includes certain considerations as to the audit firm performing that audit work. In complying with such requirements, the principal auditor essentially "checks the quality" of the work performed and further considers the "suitability" of the other audit firm. Consequently, inspection of that same firm and review of that same work by the PCAOB would represent a doubling of effort. In any case, the very fact that an inspection of that other

firm had been carried out by the PCAOB would not relieve the principal auditor of the obligation to "check the quality" of this work performed by the other audit firm; this fact would only be relevant to the principal auditor's consideration of the "suitability" of the other audit firm.

Following on from this, we would like to point out that whereas the PCAOB interim auditing standards require a principal auditor make inquiries concerning the professional reputation and independence of the other auditor, irrespective of whether or not the principal auditor decides to make reference to the audit performed by the other auditor, Revised and Redrafted International Standard on Auditing 600 "Special Considerations— Audits of Group Financial Statements (Including the Work of Component Auditors) specifies, among other things, in more detail the understanding the group engagement team is required to obtain of the "other" or component auditor at the stage when there are plans to request a component auditor to perform work on the financial information of a component. This understanding extends, in paragraph 19(d) of that Standard, to whether the component auditor operates in a regulatory environment that actively oversees auditors. The requirements in ISA 600 for participation in, and review of work performed by component auditors are also considerably more comprehensive than those in the PCAOB's interim auditing standards.

In our view, such requirements properly belong in auditing standards, as they serve to ensure audit quality. We do not agree that oversight measures such as publishing relevant material on deficiencies in a firm's performance in other engagements in prior years should be passed on to principal auditors as proposed in the Release. Consideration of whether a principal auditor has adhered to the requirements of auditing standards designed to ensure the quality of work performed by other auditors is a matter for oversight authorities, but not for publication in an auditor's report. In our opinion, it would be more appropriate for this type of information to be documented by the principal auditor to evidence the audit work performed in this regard. The question that arises is whether the interim auditing standards used by the PCAOB may need to be revised to address this specific aspect in more detail, in particular given the fact that in some cases a principal auditor may, pursuant to AU 543. 06 et seq. decide not to take responsibility for work performed by an other auditor (division of responsibility).

Furthermore, when the audit firm is not also the principal auditor, the significance of any work the principal auditor uses, which has been performed by a firm that has declined to provide information or documents in response to a Board inspection demand on the basis of non-U.S. legal restrictions or sovereignty issues, ought to be considered in determining whether, and, if so, what

information would best serve the needs of investors. Indeed, if the role of such an audit firm is not a “substantial role” investors are unlikely to benefit from this information as proposed.

We hope that our comments will be useful in your further consideration of the various issues discussed. Should you have any questions about our comments, we would be pleased to be of assistance.

Yours very truly

Klaus-Peter Feld
Executive Officer