



**EUROPEAN COMMISSION**  
Internal Market and Services DG

**Director General**

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**Subject: PCAOB Rulemaking Docket Matter No. 027**

Madam, Sir,

On behalf of the Commission services, I am pleased to respond to the request for comments from the Public Company Accounting Oversight Board (the “PCAOB” or the “Board”) regarding Release No. 2008-007, Rule Amendments Concerning the Timing of certain Inspections of non-US Firms, PCAOB Rulemaking Docket Matter No. 027 (the “Release”).

I support the PCAOB's intention to establish and implement cooperative solutions with non-US oversight bodies. The leaders of the Group of Twenty (G20) have also called for regulatory cooperation in the field of auditor oversight.<sup>1</sup>

The European Commission believes that appropriate and effective cooperation with the PCAOB could result in benefits not only to the audit firms and investors, but also to the Board's inspection process. The Board has the authority, under PCAOB Rules 4011 and 4012, to rely on the inspections of non-US audit firms made by non-US regulatory authorities. The European Commission believes that joint inspections, as an ultimate objective, are not desirable. Joint inspections as a confidence building measure might be useful, but it is not a sustainable concept or even a policy objective. We would therefore welcome the PCAOB adopting its proposed policy statement giving guidance on the implementation of its Rule 4012. Adoption of this policy statement is also a premise to what is set out below.

Our response focuses in particular on the aspect of conflicts of law (see section 1). We also take the opportunity in this context to make comments on other points (see section 2).

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<sup>1</sup> Declaration Summit on Financial Markets and the World Economy, November 15 2008, paragraph 9, third and fourth bullet point.

## **1. CONFLICT OF LAW ISSUE**

The PCAOB proposes to solve conflicts of law via enhanced transparency towards US investors. However, it is unclear on its arguments in the context of sanctions on conflicts of law.

### **1.1. The situation in Europe has changed**

Before the adoption of the Statutory Audit Directive and the regulations transposing its provisions in Member States' law, the situation was as follows: the national legislation of most EU Member States did not allow an EU audit firm to fulfil its obligations under PCAOB Rule 4006.

In order to facilitate the registration process, the PCAOB therefore allows audit firms under its Rule 2105 to withhold information from its application for registration if such information would cause a conflict of law. EU audit firms used this Rule when declining to include the statement in which they would agree to co-operate with the PCAOB and to comply with its requests for information and documents in their possession as requested by Section 102 (b) (3) of the Sarbanes Oxley Act. The refusal was motivated by the impossibility for them to commit in advance to comply with all the PCAOB's future requests for information and documents, because their domestic law effectively would not allow them to do so.

Since the adoption of the European Statutory Audit Directive in 2006, EU Member States are required to establish an independent auditor oversight system, a quality assurance system and an investigations and penalties system. Member States accordingly adopted legislation to transpose these requirements into their national law. All Member States concerned by these issues have now implemented appropriate measures. Auditor oversight bodies have been established to carry out inspections and investigations on the auditors and audit firms registered with them. The starting point for co-operation is therefore no longer individual auditors or audit firms but oversight bodies. This change of custody is a proper way for handling professional secrecy issues regarding auditors and audit working papers. Professional secrecy is acknowledged as a principle under Article 23 of the Statutory Audit Directive. Exemptions related to professional secrecy are not just handled on the basis of obtaining the consent of the client company which could anyway be withdrawn at any moment. Instead, public oversight bodies are involved and should take responsibility for these issues in bilateral arrangements with public oversight bodies from third countries as required under Article 47 of the Statutory Audit Directive. Thus, the EU promotes and facilitates international cooperation between EU auditor regulators and third country auditor regulators like the PCAOB.

Under the new European audit legislation, however, a number of conditions need to be fulfilled before a transfer of information to the PCAOB by an EU auditor regulator is allowed, such as:

- a Commission decision determining the adequacy of the third country regulators to conclude such agreements with the EU oversight bodies;

- a bilateral mutual agreement concluded between the PCAOB and the EU auditor regulators;
- the transfers may only be organized between the foreign regulators and the EU oversight bodies; and
- the transfer of information respects European data protection legislation.

Today, EU audit firms have to comply with both their domestic legislation, which prevents them from transferring any documents to foreign regulators, and with the PCAOB requests for documents.

### **1.2. No sanctions for EU audit firms if they meet 4 conditions**

The PCAOB should consider that non-US audit firms cannot be forced to breach their national legislation and that solutions need to be found for solving such situations.

For this reason, we do not support sanctions in the case where the following four conditions are met.

- (1) Auditors of companies with dual listings. Imposing sanctions would otherwise force these companies to have two auditors: one for their US listing and one for their (in our case) EU listing. This might even result in more EU companies deregistering from US securities markets.
- (2) The audit firm used Rule 2105 during its registration.
- (3) The audit firm falls under a Commission Decision on Article 47 of the European Statutory Audit Directive. The Commission proposal foresees a time limitation for two reasons:
  - (a) There is at present a regulatory gap between the Sarbanes Oxley Act and EU legislation. The Sarbanes Oxley Act does not provide the PCAOB with the possibility to exchange information with EU audit regulators. Under the EU legislation, a foreign competent authority must have the ability to cooperate with the EU auditor regulators on the exchange of information. Moreover, such an exchange can only take place between EU and foreign competent authorities; and,
  - (b) there is a need for a test phase in view of mutual reliance.

This Commission proposal is intended to facilitate international cooperation through mutual agreements between EU Member States and third country auditor regulators like the PCAOB.

- (4) Data protection legislation applies. With regard to transfer of information containing personal data to the US, only transfers made within the "Safe Harbor" scheme are considered by the EU to ensure the adequate level of protection required by the EU Data Protection Directive 95/46 on the Protection of Individuals with regard to the Processing of Personal Data. Transfers to US organizations (public or private) that are not "Safe Harbor"

members do not ensure this adequate level of protection. As PCAOB is not part of the "Safe Harbor" scheme, a national data protection authority in a Member State of the European Union can only authorise a transfer on the basis of a transfer agreement concluded under Article 26 (2) of the Directive 95/46. Such agreement should contain special safeguards which are put in place with respect to the protection of the privacy and fundamental rights and freedom of individuals and as regards the exercise of the corresponding rights.

### **1.3. Clarification on how PCAOB deals with conflict of law issues**

We would also like clarification on an inconsistency in the Release. The PCAOB acknowledges that conflicts of law might exist and that they need to be solved. To this purpose, it refers to PCAOB release No. 2004-005. This release states on page A2-18 that, even though not set out in a separate rule (like Rule 2105), the opportunity for audit firms to be heard regarding the conflict of law that may arise in the context of inspections and investigations (thus also regarding Rule 4006) is provided under the Sarbanes Oxley Act and the Board's rules regarding disciplinary hearings. But in PCAOB release 2008-007 the PCAOB states that it does not view non-US legal restrictions or the sovereignty concerns of local authorities as a sufficient defence<sup>2</sup>. This might create the impression that the outcome of such disciplinary hearings would be predetermined.

Conflicts of law need to be addressed and avoided by moving to cooperative agreements among regulators. I also agree that assessing each other's oversight systems to be able to rely on each other's inspections is a long term process. In the meanwhile, the issues related to conflicts of law have to be dealt with: either the competent authorities concerned find ways to avoid them, or they need to be addressed and solved by the national legislators involved. But they cannot be dealt with by audit firms or companies.

## **2. OTHER COMMENTS ON THE ISSUES ADDRESSED IN THE RELEASE**

### **2.1. Comments whether there are other factors that should be treated as a reason to consider moving an inspection to an earlier year (see page 13 of the Release).**

We consider that one other factor should be taken into account in this regard and that one factor requires further clarification by the PCAOB.

#### *Willingness to build co-operation*

It is in the interest of our capital markets to move to cooperative agreements with each other. We would welcome the PCAOB using 2009 to assess the jurisdictions interested in full cooperation, like the EU Member States. This should lead to acceptance under the full reliance scheme under the policy statement proposed by the PCAOB in December 2007. Willingness to build such co-operation should be given the same weight as existing market capitalisation.

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<sup>2</sup> See footnote 35 on page 16 of the Release.

The European Commission advances on a parallel track. The EU granted a transitional period to a number of jurisdictions, including the US, with a view to achieving equivalence and mutual reliance on each other's oversight systems. During the transitional period, which ends in July 2010, the auditors of these jurisdictions are allowed to continue performing audits of EU issuers while not yet falling under the oversight (and thus inspections) of EU auditor oversight entities.<sup>3</sup>

*Excluding deregistered US issuers from market capitalisation calculations*

I would welcome further clarification on the issue of market capitalisation. The PCAOB proposes to base its ranking of the audit firms on the market capitalisation of their US issuer clients. If market capitalisation is used to rank audit firms, we support the PCAOB excluding from its calculations US issuers which deregistered according to SEC rules. There is no good reason for protecting US investors through inspections if the audit firm has no US clients according to SEC rules.

**2.2. Comments on the proposed public list on the PCAOB website (see page 14 of the Release)**

I support transparency on jurisdictions in which inspections have not yet taken place as a means to inform investors. Such transparency might be similar to the European Commission's transparency regarding the jurisdictions which have been granted a transitional period during which their audit firms would not fall under the oversight of our Member States.<sup>4</sup> The Decision grants the audit firms concerned a transitional period in respect to registration requirements until 1 July 2010, provided they comply with the minimum information requirements necessary for investors in Europe. Audit firms from third countries that do not fall under the transitional regime will be subject to full registration and oversight by the competent EU Member State.

Along the same lines, the proposed transparency by the PCOAB should focus on the jurisdictions concerned instead of the individual auditors or audit firms. Conflicts of law need addressing in cooperation with public oversight bodies, preferably in 2009.

**2.3. Comments on the potential benefits and drawbacks of disclosures in the audit report of delays of PCAOB inspections resulting from conflicts of law (see page 17 of the Release)**

The EU does not support disclosing information on delayed inspections in the audit report as this would sanction the company.

The final report of the advisory committee on the auditing profession to the US Department of the Treasury required the PCAOB to require larger audit firms to produce a public annual report with the information required by the EU's transparency report. We consider this transparency report as a better place for such disclosures as the information

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<sup>3</sup> The Commission proposal on the adequacy of competent authorities of third countries for the transfer of audit working papers follows the same line of building solutions towards full reliance and the same time schedule.

<sup>4</sup> See Commission Decision of 29 July 2008 concerning a transitional period for audit activities of certain third country auditors and audit entities.

applies to the auditor and not to individual audit engagements. EU audit firms are already required to publish such reports under Article 40 of the Statutory Audit Directive.

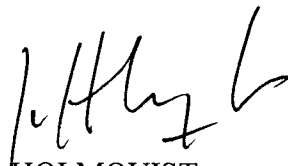
Furthermore, disclosure of this information in the audit opinion would result in companies being forced to have one audit opinion for each jurisdiction where they are listed. Multiple audit opinions are not in the interest of investors.

Finally, I would welcome clarification as to why the PCAOB does not intend to inspect auditors of subsidiaries but at the same time proposes disclosure on whether or not they were inspected by the PCAOB in the audit report.

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We would welcome the PCAOB to take the above mentioned points into consideration when deciding the amendments to its Rule 4003.

Yours sincerely,



Jörgen HOLMQUIST