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

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) PCAOB Release No. 2003-024  
) December 10, 2003  
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) PCAOB Rulemaking  
) Docket Matter No. 013  
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Summary: The Public Company Accounting Oversight Board (the "Board" or "PCAOB") has proposed rules relating to the oversight of non-U.S. public accounting firms, in the areas of registration, inspections, and investigations and adjudications. The Board is seeking comment on its proposed rules by January 26, 2004. The Board will then consider the comments, modify its proposal as necessary, and submit the proposal to the Securities and Exchange Commission (the "Commission") for its approval pursuant to Section 107 of the Act. The Board's rules relating to the oversight of non-U.S. firms will not take effect unless approved by the Commission.

Public  
Comment: Interested persons may submit written comments to the Board. Such comments should be sent to the Office of the Secretary, PCAOB, 1666 K Street, N.W., Washington, D.C. 20006-2803. Comments may also be submitted by e-mail to [comments@pcaobus.org](mailto:comments@pcaobus.org) or through the Board's Web site at [www.pcaobus.org](http://www.pcaobus.org). All comments should refer to PCAOB Rulemaking Docket Matter No. 013 in the subject or reference line and should be received by the Board no later than 5:00 p.m. EST on January 26, 2004.

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### Board

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The Sarbanes-Oxley Act of 2002 (the "Act") 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 U.S. public companies.<sup>1/</sup> Specifically, Section 102 of the Act prohibits accounting firms that are not registered with the Board from preparing or issuing audit reports on U.S. public companies or from participating in these activities. Moreover, Section 104(a) of the Act directs the Board to conduct a continuing program of inspections to assess the degree of compliance of each public accounting firm registered with the Board, and that firm's associated persons, with the Act, the rules of the Board, the rules of the Commission, and professional standards in connection with the performance of audits, the issuance of audit reports, and related matters involving U.S. public companies. In addition, Section 105 of the Act grants the Board broad investigative and disciplinary authority over registered public accounting firms and persons associated with such firms. To implement these directives, the Board has adopted rules on registration, inspections, and investigations and adjudications.<sup>2/</sup>

Furthermore, Section 106(a) of the Act provides that any non-U.S. public accounting firm that prepares or furnishes an audit report with respect to any U.S. public company is subject to the Act and the rules of the Board and the Commission issued

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<sup>1/</sup> This release uses the term "U.S. public companies" as shorthand for the companies that are "issuers" under the Act and the Board's rules. This includes domestic public companies, whether listed on an exchange or not, and foreign private issuers that have either registered, or are in the process of registering, a class of securities with the Commission or are otherwise subject to Commission reporting requirements.

<sup>2/</sup> See PCAOB Release No. 20003-007, Registration System for Public Accounting Firms (May 6, 2003); See PCAOB Release No. 20003-015, Rules on Investigations and Adjudications (September 29, 2003); See PCAOB Release No. 20003-019, Inspection of Registered Public Accounting Firms (October 7, 2003).

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under the Act, in the same manner and to the same extent as a public accounting firm that is organized and operates under the laws of any state of the United States.

The Board recognizes that certain aspects of the registration, inspection, investigation and adjudication provisions of the Act and the Board's rules raise special concerns for non-U.S. firms. In an effort to address such concerns, the Board has developed a framework under which, with respect to non-U.S. firms, the Board could implement the Act's provisions by relying, to an appropriate degree, on a non-U.S. system. The Board has outlined the broad parameters of this cooperative framework in its Briefing Paper on Oversight of Non-U.S. Public Accounting Firms.<sup>3/</sup>

As recounted in the Briefing Paper, the Board has been engaged in a constructive dialogue with many of its foreign counterparts concerning reforms in the oversight of auditing firms that audit companies whose securities trade in public markets 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, improving audit quality, ensuring effective and efficient oversight of audit firms, helping to restore the public trust in the auditing profession and buttressing the efficient functioning of the capital markets.

As also explained in the Briefing Paper, underlying this convergence of views is the global nature of the capital markets. As witnessed in the recent past, the global nature of the capital markets allows the effects of a corporate reporting failure in one country to ripple through the financial markets of another, potentially causing substantial financial damage. In an effort to avert further reporting failures and to help promote the integrity of the capital markets throughout the world, the PCAOB seeks to become partners with its non-U.S. counterparts in the oversight of the audit firms that operate in the global capital markets. To that end, the Board believes that it is in the public interest, and the interest of 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

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

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create independent and rigorous auditor oversight systems. Already significant changes in the regulation of non-U.S. accounting firms have occurred in certain non-U.S. 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 would endeavor 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 vitiating the statutory mandates in the Act.

To implement this cooperative approach, the Board is proposing two rules and an amendment to a rule relating to the oversight of non-U.S. firms in the areas of registration, inspections, investigations, and sanctions. In designing these proposed rules, the Board has been guided by the view that it is in the public interest and in the interest of investors to allocate Board resources in a manner that will achieve the requirements of the Act cost-effectively and to minimize unnecessarily duplicative administrative burdens to non-U.S. registered firms.

Specifically, the Board is proposing amending a rule relating to the registration of non-U.S. firms, which is summarized below in Section A of this release. It is also proposing a rule on inspections of non-U.S. registered public accounting firms, which is discussed in Section B of the release. Further, the Board is proposing a rule on investigations and sanctions relating to non-U.S. firms, which is summarized in Section C of this release.

Sections D and E discuss the Board's cooperation with respect to its non-U.S. counterparts' auditor oversight responsibilities and the Board's dialogue with oversight bodies outside of the United States regarding future cooperation, respectively.

The Board seeks the views of interested persons on the proposed rules relating to the oversight of non-U.S. public accounting firms. Section F of this release describes how comments and views may be submitted to the Board.

The proposal on the registration of non-U.S. firms consists of an amendment to one rule (PCAOB Rule 2100) and an amendment to a form (PCAOB Form 1) plus a

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related definition. The proposal on inspections consists of one rule (PCAOB Rule 4011) plus a related definition. The proposal on investigations and sanctions of foreign registered public accounting firms consists of one rule (PCAOB Rule 5113). The text of these proposals and a discussion of each are attached as Appendices 1 and 2, respectively.

### A. Board's Proposed Rule on Registration

As stated in previous releases,<sup>4/</sup> the Board's rules regarding the registration, inspection and investigation of non-U.S. firms raise special issues. To address more specifically the nature and scope of the Board's oversight, the Board is issuing the proposed rules and accompanying guidance described in this release related to inspections, investigations and adjudications. In order to permit non-U.S. firms a reasonable period of time to consider and prepare for implementation of these proposals, the Board is also proposing to amend a registration rule to provide a three-month extension of the registration deadline for foreign public accounting firms (i.e., until July 19, 2004).

The Board is also amending the instructions to Form 1 to include Exhibit 99.3, in order to provide non-U.S. accounting firms that expect to petition the Board in accordance with proposed PCAOB Rule 4011<sup>5/</sup> an opportunity to provide the Board with some preliminary information about the applicant's home country oversight system. This exhibit would be optional and would allow an applicant to include the name and address of its foreign registrar<sup>6/</sup> or any other authority or authorities responsible for the regulation of the applicant's practice of accounting, including any authority that inspects the applicant.

Item 1.7 of Form 1 requires the disclosure of the name of any "authority" that has issued a license to the applicant authorizing it to "engage in the business of auditing or

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<sup>4/</sup> See PCAOB Release No. 20003-007, Registration System for Public Accounting Firms (May 6, 2003); See PCAOB Release No. 20003-015, Rules on Investigations and Adjudications (September 29, 2003); See PCAOB Release No. 20003-019, Inspection of Registered Public Accounting Firms (October 7, 2003).

<sup>5/</sup> Proposed PCAOB Rule 4011 is discussed in more detail in Section B.

<sup>6/</sup> See proposed PCAOB Rule 1001(f)(ii).

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accounting." Although the Board recognizes that in certain instances the information that may be provided in response to Exhibit 99.3, and that is required by Item 1.7, may be identical, the optional nature of Exhibit 99.3 is not intended to override the disclosure requirement of Item 1.7.

Existing PCAOB Rule 2101 allows for the possibility that a non-U.S. firm could register with the PCAOB by submitting the required application via its home country registration entity, if required by that entity, which then would submit it to the PCAOB.<sup>7/</sup> The rule generally requires such an application, like all applications, be filed electronically with the Board through the Board's web-based registration system. If the applicant has difficulty submitting the application in electronic form, it may request that the Board permit the applicant to file in paper form.

### B. Board's Proposed Rule on Inspections for Non-U.S. Registered Firms

#### 1. Statutory Background on the Proposed Rule

Section 104(a) of the Act directs the Board to conduct a continuing program of inspections to assess the degree of compliance of each registered public accounting firm and associated persons of that firm with the Act, the Board's and the Commission's rules, and professional standards in connection with the performance of audits, the issuance of audit reports, and related matters involving U.S. public companies. In conducting an inspection, Section 104(d) of the Act directs the Board to take the following steps –

- inspect and review selected audit and review engagements of the firm (which may include audit engagements that are the subject of ongoing litigation or other controversy between the firm and one or more third parties) performed at various offices and by various associated persons of the firm, as selected by the Board;

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<sup>7/</sup> Submitting a registration application through a home country regulator does not alter the information required to register with the Board or the legal effect of that registration. Applicants that submit registration applications in this fashion will be treated the same, in all respects, as those that submit registration applications directly to the Board.



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- evaluate the sufficiency of the quality control system of the firm, and the manner of documentation and communication of that system by the firm; and
- perform such other testing of the audit, supervisory and quality control procedures of the firm as are necessary or appropriate in light of the purpose of the inspection and the responsibilities of the Board.<sup>8/</sup>

The Board has adopted rules relating to inspections of registered public accounting firms.<sup>9/</sup> Specifically, PCAOB Rule 4000 subjects every registered public accounting firm to all such regular and special inspections as the Board may from time-to-time conduct in order to assess the degree of compliance of each registered public accounting firm and associated persons of that firm with the Act, the Board's rules, the rules of the Commission, and professional standards, in connection with the performance of audits, issuance of audit reports, and related matters involving U.S. public companies.

Further, consistent with Section 104(d) of the Act, the Board's rules provide that a regular inspection will include, but is not limited to, the steps and procedures specified in Sections 104(d)(1) and (2) and any other tests of the audit, supervisory, and quality control procedures of the firm that the Director of the Division of Registration and Inspections or the Board determines appropriate.<sup>10/</sup> In addition, PCAOB Rule 4002 provides for special inspections that will include all steps and procedures necessary or appropriate to address the issue or issues raised by the Board when it authorized the inspection.<sup>11/</sup>

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<sup>8/</sup> See Sections 104(d)(1), (2) and (3) of the Act.

<sup>9/</sup> See PCAOB Release No. 20003-019, Rules on Inspection of Registered Public Accounting Firms (October 7, 2003). These rules are currently pending approval of the Commission.

<sup>10/</sup> Rule 4001.

<sup>11/</sup> Rule 4002.

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Under Section 106(a) of the Act, "[a]ny foreign public accounting firm that prepares or furnishes an audit report with respect to any issuer shall be subject to th[e] Act and the rules of the Board and the Commission issued under th[e] Act, in the same manner and to the same extent as a public accounting firm that is organized and operates under the laws of the United States or any State."

### 2. Overview of the Proposed Rule

The Board recognizes that inspections conducted under PCAOB Rules 4001 and 4002 raise special concerns for non-U.S. registered firms, such as unnecessarily duplicative costs and potential conflicts of law. Accordingly, as explained in PCAOB Release No. 2003-20, the Board believes that it is "necessary or appropriate in the public interest or for the protection of investors" to develop an efficient and effective cooperative arrangement where reliance may be placed, to the maximum extent consistent with the independence and rigor of the home country system, on an inspection of a non-U.S. registered firm conducted by such system.

As noted in PCAOB Release No. 2003-20, such an arrangement would have the positive effects of allowing the Board to allocate its resources in the most cost-effective manner while addressing some practical problems that the Board will face, such as those posed by the use of languages other than English. The Board also believes its arrangements may reduce potential conflicts of laws and minimize unnecessarily duplicative regulatory burdens and costs for accounting firms.

Finally, the Board believes that a cooperative approach to inspections would allow the Board to effectively fulfill its statutory responsibilities to protect the interests of investors and to further the public interest in the preparation of informative, accurate, and independent audit reports for publicly held companies without in any way vitiating any statutory authority granted to the Board. The arrangement would provide a means to meet the statutory requirements to conduct a continuing program of inspections of registered firms by building on the resources of non-U.S. inspection bodies to supplement the work of the Board's staff.

Accordingly, the Board has proposed a rule setting forth an inspection framework for non-U.S. registered public accounting firms. As a general matter, the rule would permit the Board to rely on the work of oversight systems in other jurisdictions, based on a sliding scale: the more independent and more rigorous a local oversight system,



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the greater the Board's reliance on that system. The proposed rule sets forth certain principles, described in more detail below, that the Board would apply when evaluating the independence and rigor of the home country system.

Specifically, proposed PCAOB Rule 4011 would permit a foreign registered public accounting firm to submit a written petition to the Board for an inspection that relies upon an inspection conducted by a home country system.<sup>12/</sup> The petition should describe in detail the non-U.S. system's laws, rules and/or other information to assist the Board in evaluating such system's independence and rigor. The petition should also include documents that support the firm's description of the non-U.S. system. All documents submitted as part of the petition must be in English.

The Board would consider the submission made by the firm, any other information that the Board obtains, and discussions with the appropriate entity or entities within the non-U.S. system concerning an inspection work program. Based on this information, the Board would determine the degree, if any, to which the Board, consistent with the Board's responsibilities under the Act, may rely on the non-U.S. inspection, and the Board would conduct its inspection under PCAOB Rule 4000 in a manner that relies to that degree on the non-U.S. inspection.

A decision by the Board under proposed PCAOB Rule 4011 would apply only to the particular inspection of the particular firm that submitted the petition. However, as a practical matter, the Board's assessment of a non-U.S. system in a specific jurisdiction will most likely be the same for all non-U.S. firms within the authority of that system that submit within the same general time frame. Considering petitions on a firm-by-firm basis allows the Board to take into account differences in the inspection work programs for different firms and also any changes in regulatory regimes that may occur from time to time.

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<sup>12/</sup> While not required under proposed PCAOB Rule 4011, the Board encourages interested non-U.S. firms to petition the Board as soon as practicable after approval of their registration application, in order to allow sufficient time for assessment and consultation with the appropriate non-U.S. authority.

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### 3. Principles for Determining the Independence and Rigor of a Non-U.S. System under the Proposed Rule

The Board would apply certain principles when evaluating the independence and rigor of the home country system. These principles include 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.

In assessing the adequacy and integrity of the non-U.S. system, the Board would consider, for example –

- whether an entity within the system has the 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) to –
  - inspect audit and review engagements of non-U.S. public accounting firms, including engagements that are the subject of ongoing litigation or other controversy;
  - evaluate the sufficiency of the quality control system of the firm, and the manner of the documentation and communication of that system by the firm; and
  - perform such other testing of the audit, supervisory, and quality control procedures of the firm as the entity determines necessary;
- whether an entity within the system has the authority to conduct investigations and disciplinary proceedings of non-U.S. 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, 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;
- whether an entity within the system has the authority to impose appropriate sanctions for violations of the non-U.S. jurisdiction's laws and

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standards relating to the issuance of audit reports, 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

- whether an entity within 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, including conflicts created by financial obligations to or from a former employer, business partner or client.

In assessing the independence of the non-U.S. system's operation from the auditing profession, the Board would consider, for example –

- whether the individual or individuals with whom the system's decision-making authority resides –
  - have been appointed, or otherwise selected, by the government of the non-U.S. jurisdiction; and
  - 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;
- whether a majority of the individuals with whom the system's decision-making authority resides does not hold licenses or certifications authorizing them to engage in the business of auditing or accounting and did not hold such licenses for at least the last five years immediately before assuming their position within the system;
- 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, is not practicing public accountants; and
- whether each entity within the system has the authority to conduct its day-to-day operations without the approval of any person affiliated or

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otherwise connected with a public accounting firm or an association of such persons or firms, including the authority to establish rules that provide for the operation and administration of such entity, the exercise of its authority, and the performance of its responsibilities; and to appoint full-time employees, including accountants, attorneys, and other agents as may be necessary or appropriate, and to determine their qualifications, define their duties, and fix their salaries or other compensation.

In assessing the nature of a non-U.S. system's source of funding, the Board would look to, for example, 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.

In assessing the transparency of a non-U.S. system, the Board would consider, for example, the transparency of its rulemaking procedures and the periodic reporting to the public by the system.

With regard to a non-U.S. system's historical performance, the Board would consider, for example, whether there is a record of disciplinary proceedings and appropriate sanctions. However, the Board would only consider this principle if the oversight system has been in existence long enough to have established a basis for evaluating past performance.

The criteria described above are intended as illustrative only, not exhaustive. The presence or absence of any one of the criteria would not necessarily be determinative. Moreover, the Board's decision under proposed PCAOB Rule 4011 would be based not only on an assessment of the non-U.S. system's comportment with the listed principles, but also upon the Board's judgment of whether an appropriate degree of reliance on a non-U.S. system would be consistent with the Board's responsibilities under the Act to protect the interests of investors and to further the public interest in the preparation of informative, accurate and independent audit reports for public companies.

#### 4. Agreed-Upon Work Programs under the Proposed Rule

Under the proposed inspection framework, once the independence and rigor of the non-U.S. system has been assessed using the principles described above, the staff

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of the Division of Registration and Inspections would work with the appropriate staff of the non-U.S. entity to agree on an inspection work program. In determining whether to permit any reliance on an inspection conducted by a home country system, the Board would weigh heavily the non-U.S. inspecting entity's willingness to agree to an inspection work program that includes, at a minimum, inspection of the foreign registered public accounting firm's audit and review engagements of U.S. public companies selected by the Board, including those that are the subject of ongoing litigation or other controversy; evaluation of the sufficiency of the quality control system of the foreign registered public accounting firm under the Board's standards on quality control, and the manner of the documentation and communication of that system by the foreign registered public accounting firm; possible performance of other testing of such firm; and participation of experts (who are designated by the Board) in PCAOB auditing and related professional practice standards, accounting principles generally accepted in the United States, the rules and regulations of the Commission, and other applicable standards.

The Board would also give great weight to the non-U.S. inspecting entity's willingness to agree to provide to the Board or its staff, upon their request, the inspecting entity's work papers or work product that document any inspection, evaluation or testing, and to provide to the Board, in a form and with a level of detail agreed upon with the PCAOB, a report relating to any inspection, evaluation or testing.

The allocation of work between the PCAOB staff and the non-U.S. staff would vary depending on the independence and rigor of the non-U.S. system. In jurisdictions with the highest level of independence and rigor, the inspection work program would be executed by the local inspecting body with the participation of experts designated by the Board. Participation by PCAOB staff would be greater in those jurisdictions with less independent and less rigorous systems of oversight. In jurisdictions where auditor oversight is conducted solely by a profession-organized peer review system, the Board would direct the PCAOB staff to execute the inspection work program, but could permit some assistance from the non-U.S. peer review body, which would execute certain agreed-upon modules of that program.

Ultimately, based upon a review of the non-U.S. inspecting entity's inspection work papers and inspection report, and any other work conducted by PCAOB staff, the Board would issue a PCAOB inspection report for a foreign registered public accounting firm. As with Board inspections of U.S. firms, Sections 104(f)-(h) of the Act, Board

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Rules 4007-4009 and any applicable Commission rules would govern the procedures and the firm's rights concerning draft and final versions of the PCAOB inspection report.

### **C. Board's Proposed Rule on Investigations of Non-U.S. Registered Firms**

In PCAOB Release No. 2003-020, the Board indicated that it intended to propose a rule relating to investigations of non-U.S. firms, and the Board is now proposing PCAOB Rule 5113. The proposed rule provides that, in carrying out its investigative responsibilities under Section 105(b) of the Act, 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.

In addition to the Board's assessment of the circumstances at hand, the application of proposed PCAOB Rule 5113 may depend on the non-U.S. body's willingness and authority to provide the Board or the Director of Enforcement and Investigations with access to the relevant evidence gathered in its investigation. In addition, reliance pursuant to proposed PCAOB Rule 5113 would depend, in part, on the independence and rigor of the non-U.S. investigatory authority. Further, because the Board may not always be in a position to wait until the close of the non-U.S. authority's inquiry before deciding whether to commence its own investigation, the non-U.S. authority's willingness to share information and to update the Board during the course of its investigation may also be relevant to the application of proposed PCAOB Rule 5113.

The Board believes that, in appropriate circumstances, reliance on non-U.S. investigatory authorities would serve the public interest and the interest of investors. For example, reliance may promote the efficient allocation of resources in conducting investigations. Moreover, effective and efficient enforcement by the Board may be enhanced by such reliance.

Circumstances may require, however, that the PCAOB conduct an investigation of the audit work of a non-U.S. registered public accounting firm, or an associated person of such a firm, relating to the financial statements of a U.S. public company. Proposed PCAOB Rule 5113 does not limit the Board's authority under PCAOB Rule 5200 to commence disciplinary proceedings whenever it appears to the Board that such action is warranted.



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Finally, in determining an appropriate sanction under PCAOB Rule 5300, the Board, in appropriate circumstances, may consider sanctions imposed by a non-U.S. authority. In those circumstances where the Board considers a non-U.S. sanction, the Board may impose additional sanctions or may determine that no additional sanction is necessary. When a non-U.S. disciplinary regime provides for appropriate sanctions of 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. However, the Board's consideration of a non-U.S. sanction does not, in any way, limit the Board's authority to impose a sanction under PCAOB Rule 5300.

D. Cooperation by the Board With Respect to its Non-U.S. Counterparts' Auditor Oversight Responsibilities

The Board is underscoring its willingness to work with its non-U.S. counterparts with regard to such counterpart's oversight responsibilities over a U.S. accounting firm that audits or plays a substantial role in the audits of public companies in such counterpart's home country.<sup>13/</sup> Specifically, with respect to an inspection of a U.S. firm conducted by a non-U.S. counterpart, the Board has previously announced that it would 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>14/</sup> In order not to compromise the Board's independence, however, the Board intends 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.

With respect to investigations, the Board would assist, to the extent permitted by applicable law and consistent with its reasonably available resources, in investigations by non-U.S. authorities of U.S. accounting firms that audit or play a substantial role in the audit of public companies in non-U.S. jurisdictions. In addition, in lieu of imposing its own sanctions, other non-U.S. jurisdictions may wish to rely upon sanctions imposed by the Board on a U.S. registered public accounting firm.

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<sup>13/</sup> Additional rule making is not necessary to carry out the Board's authority in this area.

<sup>14/</sup> See PCAOB Release No. 20003-020, Oversight of Non-U.S. Public Accounting Firms (October 28, 2003)

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E. Continuance of the Dialogue and Other Board Programs

The Board anticipates continuing its dialogue with oversight bodies outside of the United States in order to achieve its objectives generally, as well as to try to find ways to coordinate in areas where there is a common programmatic interest. Moreover, at the appropriate time, the Board intends to begin a dialogue with its non-U.S. counterparts on the details of the inspection work programs for individual firms in non-U.S. jurisdictions.

F. Opportunity for Public Comment

Interested persons are encouraged to submit their views to the Board. Written comments should be sent to the Office of the Secretary, PCAOB, 1666 K Street, N.W., Washington, D.C. 20006-2803. Comments may also be submitted by e-mail to [comments@pcaobus.org](mailto:comments@pcaobus.org) or through the Board's Web site at [www.pcaobus.org](http://www.pcaobus.org). All comments should refer to PCAOB Rulemaking Docket Matter No. 013 in the subject or reference line and should be received by the Board no later than 5:00 p.m. EST on, January 26, 2004.

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On the 10th day of December, in the year 2003, the foregoing was, in accordance with the bylaws of the Public Company Accounting Oversight Board,

ISSUED BY THE BOARD.

/s/ J. Gordon Seymour  
Acting Secretary

December 10, 2003

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APPENDICES –

1. Proposed Amendments to Board Rules
2. Section-by-Section Analysis of Proposed Amendments to Board Rules

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**Appendix 1 – Proposed Amendments to Board Rules**

The Board proposes to amend Section 1 of its rules by adding new subparagraphs to PCAOB Rule 1001, to amend Section 2 of its rules by striking "April 19, 2004" and substituting "July 19, 2004" in PCAOB Rule 2100, to amend Section 4 of its rules by adding PCAOB Rule 4011, to amend Section 5 of its rules by adding PCAOB Rule 5113, and to amend the Instructions to Form 1. The relevant portions of the Rules and Instructions, as proposed to be amended, are set out below.

**RULES OF THE BOARD**

**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:

\* \* \*

**(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.

**(f)(iii) Foreign Registrar**

The term "foreign registrar" means an entity, other than an entity existing under the laws of the United States or any state, with which a foreign public accounting firm is required to register.

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**SECTION 2. REGISTRATION AND REPORTING**

**Part 1 – Registration of Public Accounting Firms**

**Rule 2100. Registration Requirements for Public Accounting Firms**

Effective October 22, 2003 (or, for foreign public accounting firms, July 19, 2004), each public accounting firm that –

- (a) prepares or issues any audit report with respect to any issuer; or
- (b) plays a substantial role in the preparation or furnishing of an audit report with respect to any issuer

must be registered with the Board.

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**SECTION 4. INSPECTIONS**

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**Rule 4011. Inspections of Foreign Registered Public Accounting Firms**

(a) A foreign registered public accounting firm that is subject to an inspection under the laws, rules, or professional oversight system in the jurisdiction in which it is organized and operates may request that the Board rely on that inspection in conducting an inspection of the firm pursuant to Rule 4000.

(b) A request pursuant to paragraph (a) shall be made by submitting to the Board a written petition, in English, that describes the non-U.S. system's laws, rules and/or other information to assist the Board in evaluating such system's independence and rigor.

(c) The Board shall determine the degree, if any, to which the Board, consistent with the Board's responsibilities under the Act, may rely on the non-U.S. inspection, and the Board shall conduct its inspection under Rule 4000 in a manner that

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relies to that degree on the non-U.S. inspection. In making that determination, the Board will evaluate –

- (1) the submission made under paragraph (b);
- (2) any other information the Board may obtain 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
- (3) discussions with the appropriate entity or entities within the system concerning an inspection work program.

## **SECTION 5. INVESTIGATIONS AND ADJUDICATIONS**

\* \* \*

### **Part 1 – Inquiries and Investigations**

\* \* \*

#### **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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**FORM 1 – APPLICATION FOR REGISTRATION**

GENERAL INSTRUCTIONS

\* \* \*

11. An applicant may list the name and physical address (and, if different, mailing address) of the applicant's *foreign registrar* or any other authority or authorities responsible for the regulation of the applicant's practice of accounting, including any authority that inspects the applicant. If applicable, the applicant may provide such information as Exhibit 99.3.

\* \* \*

**PART X – EXHIBITS**

To the extent applicable under the foregoing instructions, each application must be accompanied by the following exhibits:

\* \* \*

Exhibit 99.3 Non-U.S. Oversight System Information

\* \* \*

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**Appendix 2 – Section-by-Section Analysis of Proposed Amendments to Board Rules**

The Board proposes to amend Section 1 of its rules by adding new subparagraphs to PCAOB Rule 1001, to amend Section 2 of its rules by striking "April 19, 2004" and substituting "July 19, 2004" in PCAOB Rule 2100, to amend Section 4 of its rules by adding PCAOB Rule 4011, to amend Section 5 of its rules by adding PCAOB Rule 5113, and to amend the Instructions to Form 1. Each of the amendments to the rules is discussed below.

**Proposed Amendments to Board Rules**

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

*Foreign Registered Public Accounting Firm*

The definition of non-U.S. jurisdiction in Rule1001(f)(ii) means a foreign public accounting firm that is a registered public accounting firm.

*Foreign Registrar*

The definition of foreign registrar in proposed Rule1001(f)(iii) means an entity in a non-U.S. jurisdiction with which a public accounting firm that is organized and operating under the laws of that non-U.S. jurisdiction is required to register.

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### **Rule 2100 – Registration Requirements for Public Accounting Firms**

The Board has also decided to allow non-U.S. public accounting firms an additional three months to register. Accordingly, the proposed amendment provides that the mandatory registration date for these firms is July 19, 2004.

### **Rule 4011 – Inspections of Foreign Registered Public Accounting Firms**

Proposed PCAOB Rule 4011 states that a foreign registered public accounting firm that is subject to an inspection under the laws, rules, or professional oversight system within the non-U.S. jurisdiction in which it is organized and operates may request that the Board rely on that inspection in conducting an inspection of the firm pursuant to PCAOB Rule 4000.

The rule also states that requests should be made by submitting 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 the independence and rigor of the system.

In evaluating the independence and rigor, the Board would apply certain principles including the adequacy and integrity of the system; the nature of the system's source of funding; the independence of the system's operation from the auditing profession; the transparency of the system; and the system's historical performance.

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Although not stated in the Rule, upon receiving such petition, the Board would consider criteria, for example, as described below, that indicate a non-U.S. system's comportment with the principles set forth in the Rule.

In assessing the adequacy and integrity of the non-U.S. system, the Board would consider, for example –

- the authority of the system to inspect, evaluate and perform certain testing;
- the authority of the system to conduct investigations and disciplinary proceedings;
- the authority of the system to impose sanctions for violations of the non-U.S. jurisdiction's laws and standards; and
- the authority of the system to establish and enforce ethics rules and standards of conduct;

In assessing the independence of the non-U.S. system's operation from the auditing profession, the Board would consider, for example --

- whether the individual or individuals with whom the system's decision-making authority resides –
  - have been appointed, or otherwise selected, by the government of the non-U.S. jurisdiction; and

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- may be removed only by the government of the non-U.S. jurisdiction and may not be removed by any person associated with a public accounting firm or an association of such persons or firms;
- whether a majority of the individuals with whom the system's decision-making authority resides does not hold licenses or certifications authorizing them to engage in the business of auditing or accounting and did not hold such licenses for at least the last five years immediately before assuming their position within the system;
- 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, is not practicing public accountants; and
- the authority of the entities within the system to conduct their day-to-day operations.

In assessing the nature of a non-U.S. system's source of funding, the Board would look to, for example, whether the system has an appropriate source of funding that is not subject to change, approval or influence by any person associated with a public accounting firm or an association of such persons or firms.

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In assessing the transparency of a non-U.S. system, the Board would consider, for example, the transparency of its rulemaking procedures and the periodic reporting to the public by the system.

With regard to a non-U.S. system's historical performance, the Board would consider, for example, whether there is a record of disciplinary proceedings and appropriate sanctions. However, the Board would only consider this principle if the oversight system has been in existence long enough to have established a basis for evaluating past performance.

The criteria described above are intended as illustrative only, not exhaustive. The presence or absence of any one of the criteria would not necessarily be determinative. Moreover, the Board's decision under proposed PCAOB Rule 4011 would be based not only on an assessment of the non-U.S. system's comportment with the listed principles, but also upon the Board's judgment of whether an appropriate degree of reliance on a non-U.S. system would be consistent with the Board's responsibilities under the Act to protect the interests of investors and to further the public interest in the preparation of informative accurate and independent audit reports for public companies. Generally, in jurisdictions with the highest level of independence and rigor, the inspection work program would be executed by the local inspecting body with the participation of experts designated by the Board. Participation by PCAOB staff



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would be greater in those jurisdictions with less independent and less rigorous systems of oversight.

Finally, proposed PCAOB Rule 4011 states that after considering the submission made in accordance with the Rule, any other information that the Board has obtained, and discussions with the appropriate entity or entities concerning an inspection work program, the Board shall determine the degree, if any, to which the Board, consistent with the Board's responsibilities under the Act, may rely on the non-U.S. inspection. The Board will then conduct its inspection under PCAOB Rule 4000 in a manner that relies to that degree on the non-U.S. inspection.

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

Proposed 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.

Circumstances may require, however, that the Board conduct an investigation relating of the audit work of a non-U.S. registered public accounting firm, or an

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associated person of such a firm, relating to the financial statements of a U.S. public company. Proposed PCAOB Rule 5113 does not limit the Board's authority under Rule 5200 to commence disciplinary proceedings whenever it appears to the Board that such action is warranted.

### **Form 1**

#### **General Instructions**

The amendment to the general instructions to the Form permits an applicant to list the name and physical address (and, if different, mailing address) of the applicant's foreign registrar or any other authority or authorities responsible for the regulation of the applicant's practice of accounting, including any authority that inspects the applicant. If applicable, the applicant may provide such information as Exhibit 99.3.

#### **Part X – Exhibits**

The amendment to Part X of Form 1 lists Exhibit 99.3.