

# CONSOB

Commissione Nazionale  
per le Società e la Borsa

Rome, March 27, 2003

ISSUERS DIVISION  
Corporate Controls Office

International Relations Office

Office of the Secretary  
Public Company Accounting Oversight Board  
1666 K Street, N.W.  
Washington D.C. 20006 – 2803  
United States of America

Reference no.: 3019738

Case no.: 2062709

**Subject: PCAOB Rulemaking Docket Matter No. 001.**

In this letter the competent Offices of Consob (Commissione Nazionale per le Società e la Borsa) set out their comments on the proposed registration system for public accounting firms, issued pursuant to section 102 of the Sarbanes-Oxley Act.

Consob has carefully followed the work of Congress and the SEC, leading to the enactment of the Sarbanes-Oxley Act and the consequent intense regulatory activity and to the setting up of the Public Company Accounting Oversight Board, as the body responsible for the supervision of the activity of public accounting firms in their dealings with listed companies. It is in complete agreement with the basic principles underlying the reform.

In Italy the issues addressed in the above-mentioned reform have been and are being addressed by Consob, which has always played a pivotal role in the system regulating the financial markets with a view to ensuring their proper functioning, a role that was strengthened in 1998 with the enactment of Legislative Decree 58/1998, the Consolidated Law on Financial Intermediation (“Consolidated Law”).

The Consolidated Law comprehensively revised all the legislation specifically concerned with the regulation of Italy’s financial markets and includes a series of provisions intended to guarantee the transparency of financial information and safeguard the interests of the investing public, objectives that are identical to those being pursued in the reform under way in the United States.

As regards statutory audit activity, in Italy for many years now this has been subject to rigorous supervision based on a system of registration of all the persons subject thereto. Specifically, Italian law

# CONSOb

provides for two distinct systems of registration and supervision, linked together by the establishment of some points of contact and entrusted to two authorities with different competences: Consob and the Ministry of Justice.

The Consolidated Law states that the statutory audit of listed companies and their subsidiaries and of entities that are of significant public interest in view of the nature of their activity, such as, among others, insurance companies and investment firms, must be carried out by an auditing firm entered in the Special Register kept by Consob.

Entry in the Special Register implies that an auditing firm is subject to supervision by Consob, which is entrusted with the task of verifying the independence and technical adequacy of registered firms.

The fundamental features of the present system were defined in 1975, shortly after the establishment of Consob, in Presidential Decree 136/1975. In 1998 the Consolidated Law basically confirmed the key principles of the system of supervision under Consob and took over nearly all the provisions of the 1975 decree.

The statutory audit of all other companies is performed by persons entered in the Register of Auditors kept by the Ministry of Justice pursuant to Legislative Decree 88/1992. Natural persons and auditing firms that satisfy certain requirements may be entered in this register. The supervision of such natural and legal persons is entrusted to the Central Commission for Auditors established at the Ministry of Justice, of which Consob is one of the participants. The Register of Auditors was introduced by Legislative Decree 88/1992 in implementation of Directive 84/253/EEC on the approval of persons responsible for carrying out the statutory audits of accounting documents.

Auditing firms entered in the Special Register kept by Consob must satisfy all the requirements specified in Legislative Decree 88/1992 and the additional requirements specified in the Consolidated Law. Details of the working of the system of registration and supervision of the auditing firms entered in Consob's Special Register are given in the annex enclosed with this letter.

Reference should be made to the annex for a more detailed description of the system, of which the main aspects are summarized below.

- at the time of auditing firms' entry in the Special Register, Consob verifies that they satisfy the formal and substantial requirements, with special reference to their technical adequacy;
- as a consequence of auditing firms' registration, Consob is required to supervise their activity, so as to ensure ongoing compliance with the requirements of independence and technical adequacy. If irregularities are found, Consob can adopt measures affecting auditing firms' operations forbidding further activity by natural persons and firms; it calibrates the penalty according to the seriousness of the irregularities committed;
- lastly, Consob draws up regulations, provides guidance and issues recommendations concerning the principles and standards to be adopted in audits.

Everything considered, we are convinced, after more than twenty years of experience with this system, that the guarantees and safeguards it provides are equivalent to those that the Sarbanes-Oxley Act and the related SEC and PCAOB rules are intended to establish and that they are capable of achieving the same ends as the new US legislation.

# CONSOb

We therefore consider that the conditions exist for total exemption to be granted from the registration system proposed by the Board and the consequent oversight of foreign public accounting firms that will be introduced.

This request for exemption is based on section 106 (c) of the Sarbanes-Oxley Act, which states that the SEC and the PCAOB (subject to the approval of the SEC) may, where they deem it necessary or appropriate in the public interest or for the protection of investors, either unconditionally or upon specified terms and conditions, exempt any foreign public accounting firm from the provisions of the Sarbanes-Oxley Act or the rules of the Board or the Commission.

Since Italy has a double system of supervision that ensures, through entry in the Consob Special Register and in the Register of Auditors, the oversight of all auditors and auditing firms, the registration of Italian auditing firms with the Board would clearly be a duplication, with consequent inefficiencies and an inevitable increase in costs, especially if the duplication of registration was followed by the duplication of supervision.

In the absence of forms of exemption able to re-establish the necessary “equilibrium” between legal systems, we would be faced with hard-to-manage situations of competition between systems, for the performance of both audits and supervision, characterized by inevitable inefficiencies for the persons subject to supervision and for the bodies responsible for carrying it out, as well as by inevitable additional costs for auditing firms.

In fact Italian auditing firms would be subject to two fee regimes, be required to satisfy two sets of requests for information, and have to multiply by two most of the administrative tasks they have to perform under the national system of supervision.

Moreover, similar “distortions” of the system do not appear to be justified by an obvious gain in terms of more effective guarantees for investors. On the contrary, it is highly likely that they would end up by bearing the burden imposed by dual registration.

In conclusion, we believe that granting Italian auditing firms a complete exemption from the requirement to register with the PCAOB and the rules that will be issued by the SEC and the Board itself would not in any way damage the public interest that those provisions are intended to safeguard.

Without prejudice to the request for exemption put forward above, we submit the following comments in response to the questions contained in the document published by the Board regarding the registration of foreign public accounting firms;

- the time limit of end-October for Italian auditing firms to register with the Board does not appear sufficient, in view of the quantity and complexity of the information required. We therefore consider it necessary to provide a longer period and in this respect the proposal of an additional 90 days appears reasonable;
- as regards the definition of the “substantial role” played by foreign public accounting firms in the audit of a US issuer, it does not appear desirable to establish a threshold lower than that referred to of 20%.

As for the introduction of powers of oversight of Italian auditing firms by the PCAOB, we consider, taking into account Consob’s powers described above, that the Board could use Consob to carry out its investigations, *inter alia* under the cooperation agreements already in place with the SEC.

# CONSOb

We inform you that the Consolidated Law on Financial Intermediation and the related implementing regulations issued by Consob are posted in Italian and English on Consob's website ([www.consob.it](http://www.consob.it)).

We are available to provide any further information or clarifications you may need and to meet with you in order to examine the questions addressed above in greater depth.

Sincerely yours,

Carlo Biancheri  
Head of the  
International Relations Office

Giuseppe Cannizzaro  
Head of the  
Issuers Division

N.DMS: 030790012

# CONSOB

Annex

## **The Italian system of registration and supervision of auditing firms**

### **1. Registration of auditing firms in the Special Register kept by Consob**

When an auditing firm applies for entry in the Special Register kept by Consob under Article 161 of Legislative Decree 58/1998, the Consolidated Law on Financial Intermediation (“Consolidated Law”), the latter opens an inquiry aimed at verifying that the firm satisfies the legal and administrative requirements specified in Legislative Decree 88/1992 and the additional requirements specified in the Consolidated Law.

Legislative Decree 88/192 establishes that auditing firms must have a given legal form and a restricted scope of activities. In addition, the directors and shareholders/partners of such companies must satisfy certain integrity and professional requirements. In more detail:

- a) Article 6 of Legislative Decree 88/1992 specifies the legal forms that auditing firms may have in order to perform their activity and establishes that their corporate purpose must be restricted to auditing and other services which are strictly related to the implementation of the accounting system. The latter is intended to ensure the independence of auditing firms by excluding the performance of other activities that are deemed to be incompatible.
- b) Article 6 of Legislative Decree 88/1992 also establishes that the majority of directors and shareholders/partners of auditing firms must be entered in the Register of Auditors. This rule is intended to ensure that auditing firms are controlled by persons who engage in a professional activity and who satisfy certain requirements.

In fact the natural persons entered in the Register of Auditors must satisfy professional requirements (Articles 3 and 4 of Legislative Decree 88/1992) regarding their training in economic and accounting matters and their experience, as well as integrity requirements (Article 8 of Legislative Decree 88/1992) based on the absence of convictions for certain penal offences and of recourse to plea bargaining.

Another requirement that auditing firms must satisfy in order to be entered in the Special Register is established in Article 161.4 of the Consolidated Law, which states that they must possess adequate guarantees provided by banks and/or insurance companies to cover the risks deriving from their audit activity.

Article 161.2 of the Consolidated Law states that auditing firms that apply for entry in the Special Register must satisfy the requirement of technical adequacy. For the purpose of verifying this, Consob, as part of its inquiry, carries out a quality control on applicants aimed at checking the presence of the factors necessary to ensure that, once registered, they will be in a position to perform their audit activity adequately.

To this end Consob normally carries out checks during the inquiry on the ways in which applicants have carried out their audit work verifying compliance both with auditing standards and with ethical standards of independence. Moreover the checks extend to the

# CONSOB

adequacy of auditing firms' organizational structures, including the assessment of the professional experience of the personnel employed.

In short, in its evaluation of applicants for entry in the Special Register, Consob carries out checks that are not limited to verifying that they satisfy the formal legal and administrative requirements but aimed primarily at verifying auditing firms' satisfaction of the substantial requirements concerning the audit activity they have actually performed.

The Consolidated Law authorizes Consob to ask auditing firms entered in the Special Register to provide it with periodic data on their activities. Information on all the audit engagements they are awarded and the composition of their organizational structure (as regards the personnel employed and their qualifications) must be sent to Consob every three months. Once a year, instead, auditing firms are required to transmit their financial statements and the other information of a general nature established in a Consob Communication n.91001877 of 11 April 1991 (total hours worked and billed for the year; relations with other auditing firms; information on the network they belong to and the relationship within it; and a detailed description of the quality control procedures adopted for the acceptance of new engagements, the assignment of personnel to engagements, the internal supervision of the audit work carried out, independence vis-à-vis clients and personnel hiring and training policies).

Auditing firms are also required to notify Consob within 30 days (Article 162.3 of the Consolidated Law) of every change in their shareholders/partners and directors, the transfer of shares, and any other changes concerning the legal and administrative requirements that are verified at the time of auditing firms' entry in the Special Register. In the event of the omission or late submittal of notifications of such changes, Article 193 of the Consolidated Law provides for the imposition of a pecuniary administrative sanction on the directors of the auditing firm concerned.

Companies whose financial statements are subject to statutory audit by auditing firms entered in the Special Register are however required to provide Consob with adequate information on the occasion of the appointment of the auditing firm and the revocation of the audit engagement. Article 159 of the Consolidated Law assigns Consob the task of establishing ~~in~~ a by regulation the documentation that companies conferring engagements must transmit to Consob in relation thereto.

Article 146.1 of Consob Regulation 11971/1999 on issuers implementing the above-mentioned provision of the Consolidated Law requires listed companies to send Consob copies of the following documents: the resolution adopted by the shareholders' meeting conferring the engagement, the opinion of the board of auditors on the engagement, the proposal concerning the audit engagement prepared by the audit firm, and the declarations attesting the absence of situations of incompatibility established by law between the auditing firm engaged and the company that conferred the engagement.

Article 146 of Consob Regulation 11971/1999 also specifies the content of the opinion to be rendered by the board of auditors, which is charged with evaluating the independence and technical adequacy of the auditing firm, with particular regard to the

# CONSOb

adequacy and completeness of the audit plan and the firm's organization in relation to the size and complexity of the engagement to be performed.<sup>(1)</sup>

This documentation is normally sent to Consob after the engagement has been conferred, but if the board of auditors intends to render a negative opinion on the appointment of the auditing firm chosen by the directors, this must be sent to Consob immediately.

Article 159.6 of the Consolidated Law establishes that if a company fails to appoint an auditing firm, Consob, proceeding on its own authority, must appoint one of the firms entered in the Special Register and determine the fee it is to be paid.

Where the appointment of an auditing firm is revoked, Consob must be sent copies of the following documentation: the resolutions of the shareholders' meeting revoking the appointment and appointing a new auditing firm, the comments expressed by the revoked auditing firm and the related opinion of the board of auditors. As in the case of the appointment of an auditing firm, if the board of auditors intends to render a negative opinion on the revocation, this must be sent to Consob immediately.

Auditing firms entered in the Special Register have to pay Consob an annual supervision fee based on the fees charged for statutory audits (4% for 2003). Consob also requires them to indicate in their financial statements, which have to be transmitted within 15 days of their approval, the breakdown of revenues received during the year by type of activity (statutory audits, other audits and other services which are strictly related to the implementation of the accounting system).

The legislation governing the activity of auditing firms entered in the Special Register also provides for Consob to be promptly informed whenever their work reveals problems at their statutory audit clients.

Specifically, Article 155.2 of the Consolidated Law requires auditing firms to inform Consob and the client's board of auditors without delay of any circumstances they find in their work that they deem to be censurable. A report of censurable circumstances triggers a two-pronged control mechanism, inside and outside the company in question. Indeed, on the one hand the board of auditors is required to act promptly taking all the steps within its sphere of competence, on the other the report allows Consob to take action in order to obtain clarifications and information and possibly carry out inspections, both at the company and at the auditing firm.

As regards the opinions auditing firms are required to render on their clients financial statements, Article 156 of the Consolidated Law establishes that in the event of an adverse opinion or a disclaimer the auditing firm must immediately inform Consob, giving the reasons for its decision.

---

<sup>1</sup> For a description of the role and functions of the board of auditors, see the letter Consob sent to the Securities and Exchange Commission on 25 February 2003 containing comments on the proposed rule "Standards Relating to Listed Company Audit Committees" (File No. S7-02-03").

# CONSOB

## 2. The supervision of auditing firms and related sanctions

Article 162.1 of the Consolidated Law entrusts Consob with the task of supervising auditing firms entered in the Special Register in order to verify their independence and technical adequacy. Article 161.2 specifies the powers assigned to Consob for the purpose of supervising auditing firms, whereby it can:

- a) require them to communicate data, information, records and documents periodically or otherwise, specifying the related time limits;
- b) carry out inspections and obtain information and clarifications from their shareholders/partners, directors, members of the board of auditors and general managers.

These powers enable Consob to carry out extensive controls on the entire activity of auditing firms entered in the Special Register using all the different instruments made available by the Consolidated Law.

In particular, at any time Consob can carry out inspections at auditing firms, either to verify their work in individual engagements following the emergence of facts or circumstances that require the immediate acquisition of information or to perform a more general control of the quality of registered firms' audit work and internal procedures. On the basis of the powers described above, Consob does in fact regularly conduct investigations and carry out inspections involving auditing firms entered in the Special Register.

Where during its supervisory activity Consob finds serious irregularities in the performance of audits, Articles 163.1a) and 163.1b) of the Consolidated Law authorize it to impose administrative sanctions on auditing firms entered in the Special Register. In this respect it should be noted that the sanctions specified in the Consolidated Law are calibrated according to the seriousness of the offences committed.

To this end Consob may:

- a) order the auditing firm not to use in performing audit activities, for a period of not more than two years, the person responsible for the audit in which the irregularities were found;
- b) prohibit the firm from accepting new audit engagements for a period not longer than one year.

Article 163.2 of the Consolidated Law authorizes Consob to impose a sanction that is more serious than those referred to above, the deletion of the auditing firm from the Special Register. The law provides for this sanction to be imposed when:

- a) the irregularities found are particularly serious;
- b) the requirements for entry in the Special Register are no longer satisfied and the firm does not satisfy them within a time limit, of not more than six months, established by Consob;
- c) the firm does not comply with sanctions referred to in Article 163.1 of the Consolidated Law.

Lastly, under Article 163.3 of the Consolidated Law, Consob may also delete an auditing firm from the Special Register where, for an uninterrupted period of 5 years, it has

# CONSOb

not carried out any statutory audit engagements for which the Consolidated Law prescribes entry in that register.

The measures described above can only be imposed at the end of an administrative proceeding governed by the rules contained in the law that established Consob (Law 216/1974), the Law 241/1990 and the related implementing regulations issued by Consob. The procedure starts by Consob notifying the alleged irregularities to the person responsible for the audit and the auditing firm concerned in a formal document approved by the Commission. The auditor and the auditing firm have 30 days in which to submit their objections in writing; not later than 6 months from the date the charges were brought Consob decides whether or not to impose the sanction. Sanctions imposed by Consob can be challenged by the auditor and the auditing firm concerned before the Regional Administrative Tribunal and, at the second level, before the Council of State.

Provision is made for sanctions imposed by Consob to be adequately publicized by posting them on Consob's website ([www.consob.it](http://www.consob.it)) in the weekly newsletter "Consob Informs" and by publishing the full text of the resolution in Consob's *Bollettino Ufficiale*, which is also available on the authority's website.

Article 156 of the Consolidated Law establishes that the reports issued by auditing firms entered in the Special Register on the financial statements of companies subject to statutory audit are to be signed by the person responsible for the audit, who must be a shareholder/partner or director of the firm and entered in the Register of Auditors kept by the Ministry of Justice.

In view of the links between the Special Register of auditing firms and the Register of Auditors, the Consolidated Law provides for a flow of information between Consob and the Ministry of Justice when they adopt resolutions imposing sanctions. Under Article 163 of the Consolidated Law all the sanctions imposed by Consob must be notified not only to the interested parties but also to the Ministry of Justice, which in turn has to inform Consob of all the measures it adopts with respect to persons entered in the Register of Auditors. As a member of the Central Commission for Auditors, Consob takes part in the supervision of all the persons entered in Register of Auditors.

Lastly, whenever a resolution is adopted deleting an auditing firm from the Special Register, all its clients subject to statutory audit must be promptly informed, so as to allow them to appoint another registered auditing firm. If a company fails to appoint another firm, Consob proceeds on its own authority to make the appointment and determine the fee the new firm is to be paid.

### **3. Regulation, guidance and recommendation of standards for the proper performance of audits**

The Consolidated Law lays down the fundamental principles of the auditing system and entrusts Consob with the task of implementing some of its provisions in detail by regulations.

# CONSOb

In addition to this regulatory activity, under Article 162.2c) of the Consolidated Law Consob can recommend the adoption of auditing standards and methods after consulting the Italian accounting profession.

Starting with the audits of companies' financial statements for the year ended 31 December 2002, Consob has recommended the adoption of new auditing standards based on the international standards on auditing (ISA) and the fruit of close cooperation between Consob and the Italian accounting profession.

All the communications concerning auditing issued by Consob to auditing firms are posted on its website ([www.consob.it](http://www.consob.it)).

#### **4. Criminal sanctions applicable to auditing firms**

Articles 2624 and 2638 of the Civil Code, Articles 177, 178 and 179 of the Consolidated Law and Article 622 of the Penal Code establish that auditors are criminally liable for making false statements in reports and communications related to audited companies, obstructing the performance of the functions of public supervisory authorities, entering into illegal financial relationships with audited companies, receiving illegal compensation from the same, and using and divulging confidential information obtained in the performance of an engagement.

Article 179 of the Consolidated Law provides for judgements issued against directors, shareholders/partners or employees of an auditing firm for the above-mentioned offences to be notified to Consob by the judicial authority that issued the judgement.