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Chief Executive Worldwide

Public Company Accounting Oversight Board  
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Washington  
DC 20006  
*(Being sent as an email attachment)*

31 March 2003

Dear Sirs

## **PCAOB PROPOSAL REGARDING AUDITOR REGISTRATION SYSTEM**

We welcome the opportunity to comment on the Board's proposals for registration. Our response is made on behalf of Grant Thornton International. We set out below our general comments on the proposals, followed by answers to the specific questions posed by the Board.

### **GENERAL COMMENTS**

Grant Thornton shares the primary concern of the Board, namely to restore public confidence in the major capital markets and in financial reporting by public companies, particularly in the United States which represents such a large proportion of the World's capital markets.

While we understand the urgent timetable that was set for the Board by the legislators, we believe strongly that a more measured approach should be taken in relation to accounting firms outside the United States ("foreign public accounting firms"). We believe that through a process of cooperation with foreign regulators, many of whom have already taken steps to tighten their own requirements in the wake of recent corporate collapses, the Board could achieve a broader and more dependable level of comfort about standards of auditing in connection with US public entities.

An initial approach might be for the Board to liaise with a small group of regulators (say those from the G7 countries). Such an approach would assist the staff of the Board to consider the regulatory systems that operate in each of the major territories. For this purpose, we suggest that the regulators in each identified territory be asked to submit to the Board relevant information which benchmarks their local standards against the Rules of the Board. We believe that regulators would be prepared to cooperate with the Board in this way.

The Board's proposals for registration and regulation of auditors have significant repercussions for auditors outside the United States, including the following:

- We believe that certain aspects of registration with the Board regarding members of the staff of a foreign public accounting firm would breach the Data Protection

Directive of the European Union.

- We believe that it may be unlawful to provide access to working papers to a non-local regulator in certain jurisdictions.
- We also believe that it may not be lawful to seek to compel audit staff in all jurisdictions to appear before a non-local disciplinary or investigative hearing.
- We do not have a decision as yet from insurance brokers as to whether they would allow us in all jurisdictions to register in a public forum full details of complaints and legal actions. If an accounting firm is unable to secure their agreement then it would make it impossible for many or all members of an international organisation outside the US to register with the Board.

Grant Thornton has no plans to withdraw from audits that will be regulated by the Board; however, there is a clear and active risk that the approach being considered will lead smaller audit firms to conclude that the risks and burdens are too high and many firms will decide to withdraw from such audits, thereby reducing choice and resulting in an even greater concentration of these audits, especially with the Big 4 firms. We believe that this outcome would not be in the wider interests of the market for audit services in the US or overseas.

A number of important questions arise about the scope and impact of the proposed registration system, in particular in relation to foreign public accounting firms that do not themselves prepare or furnish audit reports on any US issuers but that play a role in the audit of groups on which another firm (possibly the US member of their international network) issues audit reports. If the Board determines that it is not able (or prepared) to apply different registration arrangements (e.g. an exemption from, or extension to, registration) to foreign public accounting firms in general, we recommend strongly that it should do so in relation to foreign public accounting firms that play a "substantial role" in the audit of an issuer but do not issue audit reports on issuers for the following reasons:

- a It is not clear how firms that do not play a "substantial role" in the audit of any issuer by reference to the 20% test are to determine whether, nonetheless, they must register by reference to the first part of the definition in Rule 1001(n). As currently drafted, the Rule would appear to require subsidiary auditors to contact the issuer's auditor in each case to obtain *the other firm's view* of the significance of their involvement; only once a firm had received a reply from the issuer's auditor in respect of every subsidiary audit would it know whether it had to register (and for which clients information would have to be provided in the registration). As a result, the ability of some foreign public accounting firms to register within the 180 day period will depend directly on whether other firms are willing and able to respond on a timely basis. Because we would expect many foreign public accounting firms to be in this position, this factor could pose a threat to such firms' ability to meet the registration deadline.
- b Certain of the information that is required to support a valid registration with the Board will take time to collate. In the case of information about an issuer where a firm played (or expects to play) a substantial role, that firm may have no contact with (nor detailed knowledge about) the issuer and its audit report; as a result, the foreign public accounting firm will need to obtain this information from the audit firm

responsible for the audit of the issuer. Ad hoc requests of this sort are likely to be unwelcome at a time when auditors of issuers are preparing their own registration applications. By contrast, the auditors of issuers will already have information available about the firms that play a substantial role in those audits and we therefore recommend that this information would be more appropriately gathered through the PCAOB Form 1 (Application for Registration as a Public Accounting Firm) of the auditors of issuers.

- c Finally, registration requires explicit consent to be given of the powers and jurisdiction of the Board. Until it is clear how the Board will exercise its supervisory and disciplinary powers under the Sarbanes-Oxley Act, foreign public accounting firms will be required to register "blind". There are legal issues surrounding the Board's access to audit files of foreign public accounting firms that go to the root of the Board's supervision powers; we believe that the Board's objectives would be more appropriately achieved through recognition of, and cooperation with, local regulators.

## **RESPONSES TO THE BOARD'S QUESTIONS**

### **1. Is it feasible for foreign public accounting firms to register within 180 days of the date of the Commission's determination that the Board is capable of operating? Should foreign public accounting firms be afforded some longer period (e.g. an additional 90 days) within which to register?**

In those jurisdictions where it would be illegal for any firm to grant the PCAOB access to its audit files, it is unclear how foreign public accounting firms could agree (as part of the registration application) to consent to cooperate with the Board. Unless firms in those jurisdictions will be permitted to qualify their consent or to issue an incomplete Form 1, time will need to be allowed for the legal obstacles to be removed before those firms can be required to register.

Item 7.2 of Form 1 requires foreign public accounting firms to provide certain information about "accountants ... who participate in or contribute to the preparation of audit reports [of issuers]". It is not clear to us whether this is intended to include those who "participate in or contribute to" the audit reports on accounts of "significant" subsidiaries of an issuer (which reports in turn provide support for the audit opinion on the accounts of the issuer). We would request the PCAOB to provide clarification on this point because the answer could have a significant effect on the volume of information that foreign public accounting firms will have to gather and provide with their registration filing.

In any event, we recommend strongly that the Board should concentrate its attention on the registration of firms that are auditors of a significant number of issuers and to grant an extension (say 12 months) for foreign public accounting firms that audit, say, less than 10 issuers and (of say 24 months) for foreign public accounting firms that play a "substantial role" in the audit of an issuer but do not issue audit reports on issuers. The latter would allow time for firms that neither audit issuers nor subsidiaries of issuers that exceed 20% of the group to determine whether they need to register (see general comments above and our answer to question 5 below).

Further, even if the foreign public accounting firms were able legally to provide all of the requested information, we are concerned about the timing of the registration process. Given that the Board does not anticipate being ready to accept registration applications until late June or early July 2003, we are concerned about the ability of both foreign and domestic firms to complete the registration process by October 26, 2003. We believe that Section 102 of the Sarbanes-Oxley Act of 2002 intended to allow public accounting firms the full 180 days to complete the registration process. If firms are unable to file their registration applications until late June or early July, then firms will in effect have less than 120 days to register with the Board. The proposed Rule requires the Board to approve or disapprove a completed application for registration, or request additional information from a prospective registrant within 45 days after the date of receipt of the application. In those cases in which the Board requests additional information, a new 45-day review period will begin when the requested information is received from the prospective registrant. Since this will be the first time through the process for both the Board and the public accounting firms, requests for additional information from prospective registrants may be common, thus further tightening the time period available to firms to complete the registration process.

We therefore respectfully request that the Board:

- defers the registration deadline for certain foreign public accounting firms, as noted in the above paragraph, and
- adopts a process whereby all domestic and other foreign firms may request an extension of the October 26, 2003 completion deadline for a reasonable period of time to allow all firms the full 180 days to complete their registration with the Board.

**2. Are there any portions of Form 1 that are inapplicable, or that should be modified, in the case of non-US applicants?**

As noted in our general comments, we recommend that information required to be provided under Item 2.4 should instead be added to the information to be provided by auditors of issuers under Items 2.1, 2.2 and 2.3, together with information about the identity of the subsidiary auditor(s).

As noted in our response to the previous question, certain requirements of Form 1 conflict with laws in some non-US jurisdictions. The Board will need to give urgent consideration to whether it should accept and process registration applications that are "incomplete" in areas where such conflicts have been identified to the Board by non-US regulators.

A significant proportion of Form 1 will not apply to firms that do not perform any audits of issuers. We therefore recommend that the website for submission of registration applications should offer a simplified approach to registration by those firms that identify themselves at the outset as falling within this category.

**3. In addition to the information required by Form 1, is there any additional information that should be sought from non-US applicants?**

In order that the Board may take account of regulation and monitoring in an overseas jurisdiction, Part I of Form 1 should call for clear identification of a firm's regulatory body

(which may not be clearly evident from the information required by Item 1.7). The overseas regulatory bodies themselves should provide details of their regulatory and disciplinary arrangements so that individual foreign public accounting firms do not have to prepare and provide written summaries of this information.

**4. Do any of the Board’s registration requirements conflict with the law of any jurisdiction in which foreign public accounting firms that will be required to register are located?**

We have not had time to consider the interaction of the registration requirements with the legal rights of individuals in all jurisdictions. However, we believe that certain aspects of the registration of information about members of staff with the Board would breach the Data Protection Directive of the European Union. Also, as a general principle individuals would need to give express consent to the disclosure of certain information about them (such as history relating to breaches of criminal or civil law). Where there is information that is required to be disclosed under Item 5.5 and the relevant individuals are no longer associated with the registering firm, they would have no incentive to consent so the firm could find itself prevented from filing a complete Form 1.

In view of the significance of the legal obstacles that we believe will face many foreign public accounting firms, we suggest that the PCAOB should liaise with the European Commission and equivalent bodies in other parts of the world to clarify the legal position before requiring foreign public accounting firms to register (either at all or with this information).

**5. In the case of non-US firms that are required to register because they play a substantial role in the preparation and furnishing of an audit report on a US issuer, is the Board’s definition of “substantial role” appropriate?**

Rule 1001(n) defines the phrase “play a substantial role” to mean:

- to perform material services that a public accounting firm uses or relies on in issuing all or part of its audit report with respect to any issuer, **or**
- to perform audit procedures with respect to a subsidiary or component of any issuer the assets or revenues of which constitute 20% or more of the consolidated assets or revenues of such issuer.

Although auditors of subsidiaries may be aware of the relative sizes of their clients and the corresponding consolidated entities, this will often not be the case. Also, the first element of the test can only be applied by the auditor of the issuer.

As a result, a firm that does not audit issuers cannot determine whether it needs to register and, if so, what information is required by Item 2.4 of Form 1 without full cooperation from the primary auditors of the related issuers. Given that in the coming months those firms will no doubt be concentrating on their own registrations, there is a high risk that auditors of subsidiaries will not be in a position to register by the 180 day deadline due to a lack of information.

**6. Should the requirements to register be different for foreign public accounting firms that are “associated entities” (as defined in the Board’s rules) of US registered public accounting firms than for foreign firms that are not associated with US registered firms?**

We suggest that the information required to support the registration of a foreign public accounting firm should take account of:

- the registered status of the US member of the international network of which the firm is a member, and
- the requirements that already need to be met in order for firms to be members of the network.

For this purpose, US firms that are members of such networks could be required to file details of the quality control and other standards to which all network members are required to adhere. Foreign public accounting firms would then merely need to indicate in their registration the international network with which they are associated.

Overseas firms that are not associated with a US registered firm are likely to be viewed by the Board as having a high risk of non-compliance, so will probably justify a different, targeted approach.

**7. Should registered foreign public accounting firms be subject to Board inspection? Could the Board, in some cases, rely on home-country regulation in lieu of inspection of foreign public accounting firms? If so, under what circumstances could this occur?**

We believe that foreign public accounting firms should continue to be monitored and regulated by their local regulators. This would provide a more continuous basis for comfort by the Board than remote monitoring from the US with occasional monitoring visits. Such an approach would also recognize the national sovereignty of countries outside the US and the steps that they have taken in response to corporate failures, both recently and in the past.

The Board should reserve the exercise of its desired powers of inspection to the more serious cases of suspected break downs of standards where there is a public interest or where the Board is not satisfied with the efficacy of overseas local monitoring arrangements.

**8. Aside from Board inspection, are there other requirements of the Act from which foreign public accounting firms should be exempted? If so, under what circumstances?**

The requirements of the Act for the filing of annual reports and periodic updates of registration information have yet to be turned into rules and forms. We would ask the Board to be mindful of the possibility that arrangements within foreign public accounting firms for gathering information about clients, fees, staff and 'actions in relation to audits' may differ from (or be less sophisticated than) arrangements that would be expected to be present in US accounting firms. This should be reflected in the regularity of, and timescale for, filing updates and reports.

**9. Are there requirements different from those the Act imposes on all registered public accounting firms that the Board should apply to foreign public accounting firms?**

See earlier responses.

**10. Should the Board's oversight of foreign registered public accounting firms that are "associated entities" (as defined in the Board's rules) of US registered public accounting firms be different than its oversight of foreign public accounting firms that are not associated entities of US registered firms? Should the US registered firm have any responsibility for the foreign registered firm's compliance with the Board's rules and standards?**

We would be in favour of recognition by the Board of the value of international networks in terms of the common standards and strong self-regulation of audit quality standards that already operate within many international networks, particularly the members of the Forum of Firms.

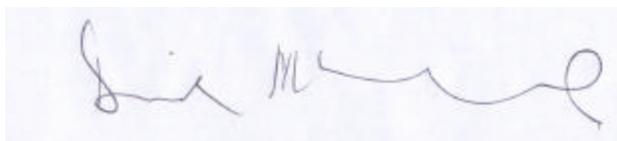
Where the US member of a network is responsible for the audit of an issuer and other network members audit significant subsidiaries, it would be logical for either the US firm or the international organisation to have oversight responsibility for compliance by member firms with the Board's Rules; however, primary responsibility for compliance would need to remain with the individual member firms.

**CONCLUDING REMARKS**

The Board has been given a difficult task to achieve within a short timescale. We hope that the Board will recognise the unique difficulties of compliance by non-US firms. Accordingly, we believe that one of the Board's first priorities should be to ensure that the registration/oversight system is appropriate in the US, where by a substantial margin the largest risks to US investors lie. Only once the Board is satisfied that the system is appropriate in the US and that compliance difficulties by non-US firms can be overcome should the Board then turn its attention to foreign public accounting firms, whose influence on reporting by US issuers is far less significant.

We should be happy to discuss any of our comments with a member of the Board's staff; for this purpose, initial contact should be made with Barry Barber at 732 516 5550 or [barry.barber@gt.com](mailto:barry.barber@gt.com).

Yours faithfully

A handwritten signature in blue ink, appearing to read "David McDonnell", written on a light blue background.

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