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

Re: Request for Public Comment on Rule Amendments Concerning The Timing Of Certain Inspections Of Non-U.S. Firms, And Other Issues Relating To Inspections Of Non-U.S. Firms (PCAOB Release No. 2008-007, Dec. 4, 2008, PCAOB Rulemaking Docket Matter No. 027)

This letter is submitted on behalf of Deloitte Touche Tohmatsu and member firms of Deloitte Touche Tohmatsu. We are pleased to respond to the request for comments from the Public Company Accounting Oversight Board (the "PCAOB" or the "Board") on its Rule Amendments Concerning The Timing Of Certain Inspections Of Non-U.S. Firms, And Other Issues Relating To Inspections Of Non-U.S. Firms (PCAOB Release No. 2008-007, Dec. 4, 2008, PCAOB Rulemaking Docket Matter No. 027) (the "Release").

In the Release, the Board requests comment on a series of related matters, as follows: (1) a proposed rule amendment that would "postpone, for up to three years, the first inspection of any non-U.S. firm that the Board is currently required to conduct by the end of 2009 and that is in a jurisdiction where the Board has not conducted an inspection before 2009"; (2) the appropriateness of "maintaining on its web site an up-to-date list of all registered firms that have not yet had their first Board inspection even though more than four years have passed since the end of the calendar year in which they first

issued an audit report while registered with the Board"[1]; and (3) establishing an approach for sanctions and disclosures for non-U.S. firms that fail to cooperate with a Board information request.[2] The Board also announced, in the Release, the adoption of a related rule that will extend until 2009 the deadlines for inspections of non-U.S. firms that were originally set for 2008 and not completed.

First, as the Board notes, the delay in inspections should be used to continue developing cooperative working relationships with non-U.S. oversight authorities, as "[t]here is long-term value in accepting a limited delay in inspections to continue working toward cooperative arrangements where it appears reasonably possible to reach them."[3] We strongly support the Board's efforts to establish cooperative relationships with non-U.S. oversight authorities.[4] We believe that these efforts will be a key step in achieving a system whereby one country's oversight authority relies on the results of an inspection performed by the home country oversight authority to satisfy its own inspection requirements. We recognize that the Board is faced with a myriad of challenges in forging these relationships. Significantly, there are complex and sensitive issues related to sovereignty, legal authority, comity, and logistics, and we recognize that the process to work through these issues is time-consuming.[5] Notwithstanding these challenges, we believe that establishing cooperative relationships with non-U.S. oversight authorities to facilitate inspections will undoubtedly further the Board's goals

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[1] Section 104(b)(1) of the Sarbanes-Oxley Act of 2002 ("SOX") requires that the PCAOB conduct inspections of registered firms that regularly provide audit reports for 100 or fewer issuers once every three years, unless the Board determines that a different inspection schedule is warranted pursuant to SOX § 104(b)(2). PCAOB Rule 4003(d)(1) permits the PCAOB to conduct an initial inspection in the fourth calendar year following the first calendar year in which the firm, while registered, issued (or played a substantial role in) an audit report.

[2] Release at 11, 14, and 15–16.

[3] *Id.* at 9.

[4] The Board's cooperative arrangements presumably will address legal and other impediments to the Board's inspection requests to non-U.S. firms.

[5] *See id.* at 6 (noting that the "need . . . to try to resolve potential conflicts of law, or to evaluate a non-U.S. system" involves "effort [that] can be substantial.").

of protecting investors, improving audit quality, ensuring effective and efficient oversight of audit firms, and helping to preserve the public trust in the auditing profession. Given the importance of these cooperative arrangements, we support the deferral of the inspection schedules and, indeed, urge the Board to allow for additional flexibility beyond the proposed extension to achieve this objective.

Second, we believe the Board should consider the extent to which the transparency afforded by the publication of a list of audit firms that have not been inspected will actually enhance investor protection, and whether there are different types of disclosures that would better serve investors' interests in obtaining information about the PCAOB's progress in conducting inspections. In particular, we believe that listing only those firms that have not yet had their first Board inspection could seriously and unnecessarily harm non-U.S. firms and, potentially, the issuers whose financial statements they audit, and could cause confusion among investors. The proposed list also could be perceived as reflecting unwillingness on the part of a non-U.S. oversight authority to cooperate with the Board, or even a lack of good faith by such oversight authority in negotiating cooperative arrangements, and so hamper cooperation with them. If the Board nevertheless determines to move forward with a list, we suggest that a list of firms that have already been inspected, or a list that sets forth the status of inspections for all firms (in either case, along with appropriate explanatory language), would reduce, although not completely eliminate, the problems associated with publishing a list.

Third, we have concerns regarding the suggested disclosures for when information requested by the Board is not provided by the non-U.S. firm. Fundamentally, we question the premise for such disclosures: a purported Rule 4006 violation due to any instance of not providing information in the face of a legal impediment under the non-U.S. firm's home country law. This position places non-U.S. firms in a potentially untenable situation; the approach also would prejudice such firms' issuer clients as the disclosures could raise concerns about audit quality and, hence, the issuer's financial statements. Moreover, the specific disclosures regarding non-cooperation under consideration by the Board

represent a significant change from existing auditing standards, and would cause confusion for issuers and investors.

I. The Board Should Extend Deadlines For 2009 Inspections Of Non-U.S. Registered Firms, Should Reserve The Flexibility For Further Extensions If Needed To Facilitate Cooperation With Non-U.S. Oversight Authorities, And Should Maintain Flexibility In Scheduling Inspections

A. An Extension Of Time Is Appropriate

As the Board has noted, a delay in completing inspections can be justified where the delay serves investors' long-term interests of establishing cooperative arrangements that facilitate inspections of non-U.S. firms.[6] We therefore urge the Board to use the additional time that it would gain by adopting the proposed deferral to initiate, or continue, discussions with the relevant oversight authority in each applicable country, rather than proceeding with inspections where cooperative arrangements have not yet been finalized.

Several leaders within the global community of audit oversight authorities have recently discussed the more general point that greater cooperation is imperative for future regulatory effectiveness. Specifically, as Chairman Olson recently stated, the current financial crisis "demonstrates [that] the global nature of today's markets demands a framework that emphasizes enhanced cross-border collaboration and cooperation among financial supervisors" and "[t]here is no doubt that current events fundamentally underscore the necessity of cross-border dialogue and cooperation."[7] Charlie McCreevy, the EU Commissioner for Internal Markets, also has stated that "[Previously], I discussed the need for effective global cooperation between all auditing regulators.

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[6] *See id.* at 9 ("[T]he purposes of the Act, the public interest, and the protection of investors are better served by delaying a first inspection to work toward a cooperative resolution than by precipitating legal disputes involving conflicts between U.S. and non-U.S. law that could arise if the Board sought to enforce compliance with its preferred schedule without regard for the concerns of non-U.S. authorities."). Although the Board states this is true only "[u]p to a point," we believe that working toward cooperative arrangements is a critical first step.

[7] Speech by Mark W. Olson, PCAOB Chairman, to the Fédération des Experts Comptables Européens Conference on Audit Regulation (Dec. 9, 2008).

And today's economic situation only reinforces this need. We need to build a global dialogue to work together towards independent high quality audit oversight."[8] And the Japan Financial Services Agency has similarly noted that "it is critical both for the Board and the JFSA/CPAAOB to develop a practical cooperative framework in pursuing common responsibilities . . . ."[9] These sentiments were also expressed during the G20 summit in November 2008,[10] and build on themes that have been discussed more broadly over the preceding several years.

We agree that cross-border cooperation among audit oversight authorities is necessary, particularly for an effective and efficient inspection function.[11] We therefore support the Board's decision to extend the time in which initial inspections must be accomplished in order to allow the

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[8] Speech by Charlie McCreevy, European Commissioner for Internal Markets and Services, to the Fédération des Experts Comptables Européens Conference on Audit Regulation (Dec. 9, 2008).

[9] Letter from Junichi Maruyama, Deputy Commissioner for International Affairs, Japan Financial Services Agency, to the PCAOB (Mar. 4, 2008) (comments on 4012 proposal) (noting also that "we believe it essential to develop an effective cooperative arrangement between the JFSA/CPAAOB and the Board in conducting public oversight activities").

[10] *See* Group of Twenty Finance Ministers and Central Bank Governors, Declaration of the Summit on Financial Markets and the World Economy (Nov. 2008) ("We call upon our national and regional regulators to formulate their regulations and other measures in a consistent manner. Regulators should enhance their coordination and cooperation across all segments of financial markets, including with respect to cross-border capital flows. Regulators and other relevant authorities as a matter of priority should strengthen cooperation on crisis prevention, management, and resolution.").

[11] *See* Letter from Deloitte Touche Tohmatsu to the PCAOB at 2 (Jan. 26, 2004) (commenting on Rulemaking Docket No. 13 relating to the oversight of non-U.S. public accounting firms) ("We agree with the Board that its oversight of non-U.S. public accounting firms raises 'special concerns' and that the best way to address these concerns is through a 'cooperative arrangement' with non-U.S. regulators of the accounting profession. Specifically, we concur with the Board that it should 'seek[] to become partners' with non-U.S. regulators in their common enterprise to enhance audit quality and to protect the global capital markets from potential corporate reporting failures."); *see also* Letter from Deloitte Touche Tohmatsu to the PCAOB at 2 (Mar. 4, 2008) (commenting on Release No. 2007-11 relating to guidance regarding the implementation of Rule 4012) ("Full reliance by the Board on designated non-U.S. oversight entities will help to promote an efficient regulatory model that minimizes duplicative inspections and decreases the costs and burdens shouldered both by the Board and registered non-U.S. audit firms." Also, "collaboration will further the Board's goals of protecting investors, improving audit quality, ensuring effective oversight of audit firms, and helping to preserve the public trust in the auditing profession.").

Board sufficient time to negotiate cooperative arrangements with non-U.S. oversight entities that facilitate inspections.

B. More Time, Beyond The Proposed Extension, May Be Needed To Achieve Cooperation

We also urge the Board to consider whether additional time to complete inspections of non-U.S. firms, beyond that set forth in the proposed extension, may be warranted in some circumstances. As reflected in the Board's proposal, the sovereignty, legal authority, comity, and logistical issues that have affected the inspection schedule thus far are complex and delicate. Indeed, it can be anticipated that in some circumstances legislative solutions may be required in order for an acceptable resolution to be achieved. Even absent the need for legislative action, the Board will require substantial time to:

- *Study the non-U.S. oversight entity's regulatory framework and the rules within which it, and non-U.S. firms, operate*. In order to establish cooperative arrangements, the Board should form an understanding of the framework within which the non-U.S. oversight authority supervises its registered firms, and other legal restrictions, such as privacy laws, that may constrain the conduct of non-U.S. firms. As the Release recognizes, there are nearly as many countries where no inspections have yet occurred as there are countries where the Board has completed at least one inspection. As a result, it would seem that a significant additional amount of time may be needed to conduct the study of the relevant jurisdictions.

- *Finalize cooperative arrangements with the non-U.S. oversight authority*. As noted above, reaching agreements with non-U.S. oversight authorities can be a time-consuming process, both in terms of resolving sovereignty or legal impediment issues, as well as reaching agreement on numerous technical issues (for example, questions about the scope and timing of the inspection, as well as the production of documents and personnel for interviews) that cooperation requires.[12]

- *Coordinate the inspection process with the non-U.S. oversight authority*. The non-U.S. oversight authority may have a different inspection schedule and/or frequency timeline, and both it and the PCAOB should be sensitive to the need to modify schedules so that inspections can be synchronized to the extent feasible.

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[12] Also, at least with respect to countries within the European Union, implementation of Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts (May 17, 2006) may result in the need to negotiate "arrangements" under Article 47 of that Directive, regarding the transfer of working papers by non-U.S. firms, in order to achieve cooperation going forward.

We support the Board's efforts, and urge the Board to continue to push for cooperative arrangements. But, the number of moving parts in the inspection process, including the challenges listed above, calls for a high degree of flexibility on the part of all parties involved in order to engender a positive dialogue toward cooperation. This flexibility should allow for progress toward the overall objective of an effective and efficient inspection regime. We urge the Board to use its authority to reserve for itself in the final rule additional flexibility, beyond the three years currently contemplated by the Release, where, for example, the Board is engaged in productive dialogues regarding cooperative arrangements that have not yet concluded.

For the same reasons, the Board's new rule extending, by a single year, inspections originally scheduled in 2008 may not be sufficient to allow the Board and the non-U.S. oversight authorities to work through impediments to the Board's inspections. Inspections covered by this one-year extension may involve countries where the Board has a realistic possibility of establishing cooperative working relationships with those countries' oversight authorities, but not within the one-year allowed by the Board's rule. We are concerned, therefore, by the Board's statement that it "does not intend . . . to make any further adjustments to the inspection frequency requirements applicable to firms whose first inspection was due no later than 2008."[13] We understand that the Board may perceive that there are differences between the 2008 extension and the 2009 extension, to the extent that the Board is already prepared to conduct the 2009 inspections based on its preparations for the 2008 schedule. Yet, we believe that, in both instances, cooperation between oversight authorities is in the long-term interests of investors. We urge the Board to be mindful of the need for flexibility with respect to the time limit in its final rule on the 2009–2012 timetable, and, if appropriate, to extend further the 2008–2009 timeline for countries where additional time would facilitate the conduct of the inspections.

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[13] Release, at 9.

C. The Board Should Maintain Flexibility In Scheduling Inspections

The Board suggests that it would "sequence [its outstanding] inspections such that certain minimum thresholds [as to the non-U.S. firms to be inspected] would be satisfied in each of the years from 2009 to 2012. The minimum thresholds would relate to U.S. market capitalization of firms' issuer audit clients."[14] We believe the Board's approach for prioritizing these inspections strictly according to "minimum thresholds" of issuer market capitalization, without consideration of other relevant factors, could result in interim deadlines that are counterproductive and inconsistent with investors' long-term interests.

The Board proposes to place each non-U.S. firm into one of four groups, based solely on the market capitalization of the firms' issuer audit clients, and then to inspect one group per year in each year from 2009 through 2012. This schedule does not appear to take into account where each individual firm is located and how complicated the path to cooperation might be in that jurisdiction. This proposal could unfairly disadvantage the non-U.S. firms that audit the largest issuers (and that may be therefore placed in the 2009 group) by affording them no extension of time whatsoever, even if they are located in jurisdictions where legal impediments to providing information to the PCAOB may exist, and the process of seeking cooperative arrangements is underway but may take longer to achieve. The Board's proposal could similarly disadvantage firms whose inspections are scheduled for 2010 or 2011 (rather than 2012). Scheduling inspection deadlines based on criteria not related to the Board's ability to reach agreement with non-U.S. oversight authorities seems to be inconsistent with the purpose of the extension and could harm these firms and impair the Board's chances for achieving cooperative arrangements in some jurisdictions where the impediments are particularly difficult and it is evident that substantial time will be required to work through the issues. Investors' long-term interests would be better served by allowing the Board to schedule inspections in such a way that

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[14] *Id.* at 11.

affords adequate time to establish cooperative arrangements in the greatest number of cases, including those presenting greater challenges.

We therefore recommend that the Board retain the flexibility to prioritize inspections based not on only market capitalization, but also on factors beyond the size of a non-U.S. firm's issuer audit clients. Other qualitative factors, such as the progress achieved toward developing cooperative arrangements, the extent to which inspections are currently conducted by the home country oversight authority and whether that oversight authority is strong, independent, and transparent, and the scheduling constraints or other difficulties encountered in conducting inspections in the non-U.S. country, should also be taken into consideration. This type of risk-based approach would be a more beneficial way to approach the scheduling of inspections, and we urge the Board to retain the flexibility to take these factors into consideration when developing its inspection schedule.

II. Public Disclosure Of A List Of Firms That Have Not Been Inspected Is Inadvisable

The Board has expressed its interest in providing transparency to investors by "maintaining on its web site an up-to-date list of all registered firms that have not yet had their first Board inspection even though more than four years have passed since the end of the calendar year in which they first issued an audit report while registered with the Board."[15] Although we recognize the benefits of transparency, we urge the Board to reconsider this proposal, for several reasons.

First, a stigma of deficiency may unnecessarily, though perhaps unintentionally, be associated with being named on a list that identifies certain firms that have not been inspected. Such a list may leave at least some investors with the impression that the non-U.S. firm had done something wrong, or failed to do something required, that warranted inclusion on the list. But this impression would be mistaken. The fact that a firm has not been inspected by the PCAOB does not mean that the firm is conducting substandard audits or is not being cooperative; a quality audit can be conducted absent a

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[15] *Id.* at 14.

PCAOB inspection. The mistaken impression that would be conveyed to investors by the proposed list could, in turn, lead to unwarranted uncertainty regarding the quality of the firm conducting the underlying audit work for a particular issuer and would prejudice issuers whose auditors are identified on the list, as doubt may unfairly be cast on the reliability of the issuer's financial statements

Second, the potential consequences to a firm that is named are particularly troubling because a firm's inclusion on the list is likely to be based on factors beyond the firm's control. Most significantly, the scheduling of the Board's inspections of non-U.S. firms is outside the control of the firms.

Third, it is unclear what caveats to or explanations of the list would be provided, or the extent to which such caveats or explanations could ameliorate the potentially negative conclusions to be drawn by issuers and investors as a result of a firm's being included on the list.

We therefore recommend that the Board refrain from publishing such a list at this time. If, however, the Board determines that some form of list related to the status of inspections is needed, we suggest that the Board implement a different type of disclosure. Specifically, one alternative would be for the Board to create a list of all the registered firms that have been inspected at least once by the Board. This list could include firms required to be inspected for which at least one inspection report has been issued, as well as firms for which the inspection process has been completed but no inspection report has yet been issued. To mitigate any potential risk of adverse inferences for those firms not on the list, the list could provide a disclosure to the effect that such firms are not included on the list for any number of reasons. To this end, we suggest that the Board consider the following text for such a disclosure:

> Some registered firms are not included on this list; this may be because of one of any number of reasons, including, but not limited to: (i) the firm's inspection is underway but not yet completed; (ii) the firm's inspection has been scheduled but not yet begun; (iii) the firm's inspection has not yet been scheduled by the Board; (iv) the firm is located in a jurisdiction with which the Board has not developed a cooperative arrangement to facilitate inspections; (v) the firm is not required to be inspected under Rule 4003; or (vi) some combination of the above.

As a second alternative, the Board could create a list that sets forth all registered firms for which the Board is required, under its rules, to conduct inspections, and the status of each such firm's Board inspection, as follows: (a) inspected and a final report issued (with a hyperlink to the most recent report issued); (b) inspected but no report yet issued; and (c) not yet inspected. A disclosure incorporating the language proposed above also could be included with the list to clarify the reasons that a firm may fall within category (c). Although neither this alternative, nor the first alternative, would avoid completely the potential stigma for non-inspected firms, it would present the issue in the overall context of the Board's inspection program and provide transparency regarding all registered firms.

In sum, we recognize the importance of providing transparency to investors as to the status of the inspection process. However, the list proposed by the Board would not be the optimum approach and could trigger significant negative consequences. If the Board believes that some form of disclosure is appropriate, we request that the Board consider the alternatives above, either of which would reduce the potential adverse consequences of the Board's suggested list to non-U.S. firms, issuers, and investors.

III. The Disclosures Suggested For When Information Is Not Provided For A PCAOB Inspection Should Be Rejected, In No Small Measure Because They Are Premised On The Faulty Notion That A Non-U.S. Firm Should Be Sanctioned When Information Is Not Provided Because Of A Legal Impediment In That Firm's Home Country

In the Release, the Board requests comment on "whether and how the fact of a non-U.S. legal restriction or sovereignty concern should be factored into the Board's consideration of the appropriate sanction to impose for a violation of Rule 4006" where a non-U.S. firm declines to provide information in response to a PCAOB request.[16] The Board also states that apart from sanctions it would impose in such circumstances, the Board is also considering "requiring a principal auditor to make certain public

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[16] Release, at 16.

disclosures as part of, or in connection with, each audit report it issues for an issuer," and requests comment "on the potential benefits and drawbacks of [such] a rule. . . ."[17] As a threshold matter, we question the premise underlying the suggested request for comment on sanctions: that non-cooperation proceedings should be initiated or sanctions imposed where a firm's failure to provide information is attributable to a home country legal impediment. We also have significant concerns regarding the suggested disclosures themselves with respect to their structure, their impact on firms and existing auditing standards, and their impact on and utility to issuers and investors.

A. Non-U.S. Firms Should Not Be Sanctioned For An Alleged Failure To Cooperate Attributable To A Legal Impediment, Particularly Where The Board Is Seeking To Negotiate Cooperative Arrangements

In setting forth these suggested disclosures, the Release proceeds from the premise that a non-U.S. firm's "failure or refusal to provide requested information is a violation of Rule 4006" even in situations where the inability to comply is attributable to a legal impediment.[18] Although the Board seeks comment on what sanctions might be appropriate in this situation, as well as comments on the suggested disclosures, we believe the Board is starting from an incorrect premise in considering these issues.

We recognize the difficulty that the Board faces when it is unable to obtain access to audit working papers or other information that it has requested in connection with its inspections. Yet, the dilemma facing non-U.S. firms is significant in this situation: they have two options, neither of which is desirable. The first option is to decline to provide the information and risk being deemed to have violated the Board's rules—in which case the Release states that the Board could seek sanctions which may include, among other things, censure, imposition of a fine, or even suspension or revocation of

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[17] *Id.*

[18] *Id.* at 16; *see also id.* n.35 ("The Board does not view non-U.S. legal restrictions or the sovereignty concerns of local authorities as a sufficient defense in a Board disciplinary proceeding instituted under Section 105(c) of the Act for failing or refusing to provide information requested in an inspection.").

registration. The second option is to provide the information and risk sanctions for violating their home country's laws, thereby subjecting the firm to home country discipline, which could include revocation of the firm's or an individual auditor's license. As such, we strongly urge the Board to reconsider its proposed application of Rule 4006 and how it proposes to balance the competing interests in this situation, in light of the considerations set forth below.

First and foremost, it is counter-productive to place non-U.S. firms in a position where they are forced to decide between violating U.S. or home country laws. An international conflict of law is often a matter between sovereigns, and therefore is a matter that is principally to be resolved at a governmental level. It is not something that the firms can resolve themselves, although we believe that firms generally should be willing to help in resolving such matters through providing insight and comments to oversight authorities in their consideration of solutions to these issues. In addition, as a practical matter, the Board may be able to avoid placing non-U.S. firms in this untenable position by undertaking to resolve certain legal impediments through negotiation with non-U.S. oversight authorities. We recognize that certain legal impediments, such as the data protection provisions in the European Union, may be outside the jurisdiction of the non-U.S. oversight authorities with which the Board is negotiating. However, the non-U.S. oversight authorities and non-U.S. firms nevertheless still may be able to assist in developing approaches to the production of information that would avoid violating legal impediments and would enable the Board to obtain information necessary to its inspections.

Moreover, the home country laws that non-U.S. firms risk violating are significant. Firms that are based in the European Union, for example, are subject to extensive data privacy regulations. *See* Directive 95/46/EC, as implemented (Article 25 of this directive restricts an EU firm's ability to transfer data to a third country unless the third country provides an "adequate level of protection" for the data). Non-U.S. firms also are subject to confidentiality restrictions—some of which include

criminal sanctions that apply to individuals who violate the regulation[19]—as well as restrictions on the transfer of working papers, such as under EU Directive 2006/43/EC. Potential legal conflicts also arise under the CPA laws, auditing standards, and codes of professional conduct of several other countries. Failure to comply with home country laws could have severe adverse consequences on the non-U.S. firm, including revocation of the firm's home country license. Simply put, the legal risks for non-U.S. firms are not just hypothetical—they are real and substantial.

Disciplinary action by the Board for a non-U.S. firm's decision to comply with its home country laws could directly or indirectly prevent the non-U.S. firm from performing audits for SEC issuers. Such a result would not be in the best interests of public companies or their investors, if for no other reason than it would limit issuers' choice of auditors. In any particular case, the issuer could be forced to seek to hire new auditors, and incur the costs of getting them up to speed to perform the audit. Or, where the non-U.S. firm plays a substantial role in auditing the subsidiary of a U.S. issuer audit client, a U.S. auditor could be forced to seek a replacement firm.

Moreover, this search by the issuer (or the U.S. auditor) to find a replacement auditor may well be unsuccessful. There may not be another auditor that has the ability to perform the work and that is not also subject to the same considerations the auditor being replaced had faced—i.e., the prospect of violating local laws. An auditor from outside the country likely would not be an option: it would not be as well positioned as a local auditor to perform the audit, given factors such as location of the relevant client documents and personnel, and linguistic and cultural barriers; it could be subject to the same legal impediments as the auditor being replaced; and, in any event, it likely would not be licensed to practice in the country.

In addition, the Board's suggested approach to Rule 4006 could undermine the formation of cooperative arrangements with relevant non-U.S. oversight authorities. PCAOB demands asking non-

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[19] *See, e.g.*, Denmark STRL 2004 § 152 (imposing penal sanctions for certain dissemination of information in violation of the professional obligation of confidentiality).

U.S. firms to violate the laws of their home countries will not engender cooperation with non-U.S. oversight authorities, particularly where the law that would be violated is enforced by the non-U.S. oversight authority itself. There is no need to jeopardize cooperative arrangements with non-U.S. oversight authorities by threatening the firms regulated by those oversight authorities with non-cooperation or discipline for their good faith compliance with the laws of their home country.

B. Public Disclosures Related To A Non-U.S. Firm's Not Having Provided Information Are Unwarranted

In the Release, the Board seeks comment on "possible rulemaking approaches that would help address aspects of the problems created by a refusal to produce information," noting that "[o]ne example that the Board has begun to consider would involve requiring a principal auditor to make certain public disclosures as part of, or in connection with, each audit report it issues for an issuer. . . ."[20] As discussed further below, we urge the Board to reject this idea.

1. The Overall Disclosure Concept Should Be Reconsidered

The Release suggests various potential disclosures related to a non-U.S. firm's failure to comply with the Board's requests. We believe that the disclosures being considered would be confusing and unhelpful to investors, would therefore be harmful to issuers, would be detrimental to establishing cooperative arrangements with non-U.S. oversight authorities, are contrary to current PCAOB standards, and would be unnecessarily punitive for firms. As such, we believe the Board should not further consider or propose any such disclosures.

The types of disclosures described in the Release would not be beneficial to investors. The fact of non-cooperation with a Board's inspection demand does not communicate information related to the quality of the audit or the quality of the issuer's underlying financial statements. The fact that a PCAOB inspection of a particular non-U.S. firm has not occurred does not mean that the non-U.S. firm's audits are flawed. Similarly, non-cooperation with a Board request—particularly where the

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[20] Release, at 16.

non-cooperation is directly attributable to the non-U.S. firm's compliance with its home country laws—does not mean that the firm has performed substandard audits. Moreover, the period in which the non-U.S. firm is alleged not to have cooperated may have no relationship to the period being audited and reported on. Yet, the suggested disclosures risk misleading investors into believing that there is a problem with the financial statements or the audit work, or both. Issuers would, in turn, be harmed by investors harboring such a misconception.

In addition, the suggested disclosures could obscure other disclosures in the current auditor's report—disclosures that are relevant to users of the financial statements because they bear on the presentation of the issuer's financial statements or on the nature and scope of the audit. Moreover, the Release does not address how or whether the suggested disclosures would be affected in instances where not providing information because of a legal impediment does not impact the Board's ability to complete an inspection.

2. The Specific Disclosures/Representations Suggested In The Release Are Problematic

In addition to the general concerns discussed above, the individual disclosures identified in the Release raise a number of significant issues. Where we discuss below issues present with respect to one of the proposed disclosures, we do not repeat in detail our discussion of these issues for each subsequent disclosure to which they are applicable.

Part A: "If the principal auditor has failed to provide information in response to an inspection demand on the basis of non-U.S. legal restrictions or sovereignty concerns, the principal auditor would need to disclose that fact as part of, or in connection with, its audit report."

First, it is not clear what would be the objective of such a disclosure. As discussed above, it is questionable whether investors or issuers would benefit from the disclosures, and it is likely that non-U.S. firms would be harmed. Second, it is not clear where—in the audit report or otherwise "in connection with the audit report"—this information would be provided. We believe that the audit report is not an appropriate place for these disclosures. Audit reports fulfill a specific, established role

with regard to the examination of the financial statements of an issuer, as set out in PCAOB auditing standards: they are carefully crafted to present information relating to the audit of the issuer's financial statements for a specific time period. The proposed disclosures would thus run contrary to the purpose of the audit report, focusing instead on the conduct of the auditor in relation to the Board's oversight function.

Second, it is not clear what a reader of the audit report is to take from such a disclosure—the implication seems to be that the principal auditor does not perform quality audits, but there is no specific relationship between the two. Subjecting the audit report to the type of disclosures identified in the release raises the risk that the audit report will become a repository of statements and assertions unrelated to its purpose—which is to provide information to investors about the nature and scope of the audit and whether the accompanying financial statements are reasonably stated. If the suggested disclosures are contemplated to be provided in connection with (but not as a part of) the audit report, it is also unclear how, where, when, and to whom these disclosures would be provided.

Part B: "In each case, the principal auditor would need to make a representation about whether the principal auditor used the work of any registered firm that has declined to provide information or documents in response to a Board inspection demand on the basis of non-U.S. legal restrictions or sovereignty concerns."

The parameters and nature of the suggested "representation" are unclear, and the answers to several clarifying questions would facilitate our providing more focused comments on this disclosure. For example, this suggestion does not address how the principal auditor could or would learn of the participating auditor's declining to provide information. This suggestion also does not address: what form these representations would take (e.g., are they intended to appear as part of audit reports, or otherwise); to whom the representations would be directed (e.g., to issuers, to regulators, to investors);

for how long the disclosure would be required; and whether the representations would be required regardless of whether the principal auditor assumes responsibility for the participating firm's work.[21]

Part C: "If the principal auditor uses the work of any [non-cooperative] firm and assumes responsibility for that work . . . the principal auditor would have to disclose (a) the identity of the firm, (b) the nature of the work performed by the firm, (c) any steps the principal auditor took to assure itself concerning the firm's and the relevant individuals' familiarity with relevant professional standards, ability to perform the work adequately, and the adequate performance of the work, (d) any other procedures on which the principal auditor relies to monitor or assess the firm's performance of audit procedures in the audits of issuers, and (e) a brief summary of any information available to the principal auditor about deficiencies in the firm's performance of any such procedures in the two-year period preceding the date of the audit report."

As noted with respect to the previous disclosure suggestions, it is not clear how or where these disclosures would be made, or to whom. If it is suggested that such disclosures would appear in the audit report, this would be inconsistent with current standards: where the principal auditor takes responsibility for the overall audit, only the principal auditor is named in the audit report, and mention of any participating auditors is omitted. Specifically, PCAOB's Interim Auditing Standard ("AU") 543.03, *Part of Audit Performed by Other Independent Auditors*, states, "[i]f the principal auditor decides to assume responsibility for the work of the other auditor insofar as that work relates to the principal auditor's expression of an opinion on the financial statements taken as a whole, no reference should be made to the other auditor's work or report." (Emphasis added.)[22] Similar statements are made in AU 543.04, explaining that referring to another auditor when the principal auditor takes responsibility "may cause a reader to misinterpret the degree of responsibility being assumed." It is not clear how these standards would be harmonized with the contemplated disclosures, which may instead require that the participating auditor be specifically named and discussed, even where the primary auditor takes full responsibility for the work.

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[21] In addition, the suggested disclosure does not address any obligations the principal auditor may have with respect to the decision of the participating auditor not to provide information.

[22] Of course, were the principal auditor to decide, under AU 543.06, to make reference to the other auditor's work, the concerns expressed in our comments to Part D of the proposal would be raised here instead.

In addition, AU 543.12 describes procedures that must be undertaken if a principal auditor decides not to make reference to a participating auditor's work. It is not clear how the suggested disclosures would relate to AU 543.12. For example, under this standard, the principal auditor must review the engagement completion document, a list of significant fraud factors, the auditor's response, the results of related procedures, and significant deficiencies in internal control. The Board's contemplated disclosures would need to be specifically harmonized with these existing requirements.

Part D: "If the principal auditor used the work of any [non-cooperative] firm and makes reference to the audit of the other auditor . . . the auditor would have to disclose, in addition to the division of responsibility described in AU 543.07, the identity of the firm and the other information described in the preceding sentence."

The disclosures discussed in Part D would apply, unlike those in Part C, to circumstances in which the principal auditor has decided that it will, under AU 543.06, make reference to the work of another auditor. These suggestions are problematic for two reasons.

First, AU 543.07 provides that "[t]he other auditor may be named but only with his express permission and provided his report is presented together with that of the principal auditor." The Board's suggestion would require that the firm be named, regardless of whether it consented, which is a potential conflict with AU 543.07, if the other auditor does not consent.

Second, AU 543.08 states that "[r]eference in the report of the principal auditor to the fact that part of the audit was made by another auditor is not to be construed as a qualification of the opinion but rather as an indication of the divided responsibility between the auditors who conducted the audits of various components of the overall financial statements." The example provided in AU 543.09 of the type of reference currently required to be made is a brief one, focusing on explaining the division of authority. The additional disclosures called for in Part D conflict with the direction in AU 543.08/.09 and are a source of potential confusion for investors, who may perceive the disclosure to constitute a qualification of the opinion.

3. A Report Providing An Overview Of Information Related To Negotiations With Non-U.S. Oversight Authorities Could Provide An Effective Alternative To The Disclosures Proposed By The Board

If the Board perceives that additional transparency regarding these issues is needed, then, in place of the suggested disclosures discussed above, the Board should consider publishing a report—for example, under Rule 4010—that provides information related to its inspections and cooperative arrangements with non-U.S. oversight authorities. Adequate transparency could be provided to investors through this report.

The report could inform Congress and the public about the issues the Board has encountered in seeking to achieve cooperative arrangements. A PCAOB report detailing obstacles faced in trying to conduct inspections would allow for focus to turn to objective impediments which apply across particular audits and non-U.S. jurisdictions, as opposed to adoption of the proposed disclosures that provide little if any context and questionable benefit to interested parties. In addition, such a report could, in a fair and objective manner, identify the nature (including the extent) of the conflict. Investors would also be able to review the information to determine the importance of these obstacles to their investment decisions.

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In sum, we support the Board's recognition that international cooperation in the oversight of auditors is in the best interests of investors, issuers, firms, and other stakeholders in the capital markets. We urge the Board to reexamine the matters discussed above relating to scheduling inspections of non-U.S. firms, providing disclosures about non-U.S. firms that have not received an inspection, sanctioning non-U.S. firms for declining to provide information because of a legal impediment, and requiring disclosures of such actions, because we believe these proposals and suggestions in many respects are harmful to investors, issuers, and non-U.S. firms, and would not advance the formation of cooperative arrangements. We thank the Board for the opportunity to

comment on the Release. If the Board has any questions about the contents of our comments, please contact Jens Simonsen at (212) 492-3689.

Very truly yours,

/s/ Deloitte Touche Tohmatsu

cc: Mark W. Olson, Chairman of the Board
Daniel L. Goelzer, Board Member
Bill Gradison, Board Member
Steven B. Harris, Board Member
Charles D. Niemeier, Board Member
Thomas J. Ray, Chief Auditor
George H. Diacont, Director

Mary L. Schapiro, Chairman
Kathleen L. Casey, Commissioner
Elisse B. Walter, Commissioner
Luis A. Aguilar, Commissioner
Troy A. Paredes, Commissioner
James L. Kroeker, Acting Chief Accountant
Paul A. Beswick, Deputy Chief Accountant