Consumer Federation of America

March 4, 2008

Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington, D.C. 20006-2803

Re: PCAOB Release No. 2007-011

Dear Sir or Madam:

I am writing on behalf of the Consumer Federation of America (CFA)[1] to express our strong opposition to the proposed Guidance Regarding Implementation of PCAOB Rule 4012. Disingenuously characterizing this radical change in policy as merely "further guidance about the Board's implementation of an existing rule," the Board fails to provide any meaningful evidence of either the need or justification for this proposed change in its approach to inspecting foreign public accounting firms. Nor does it provide any evidence that non-U.S. auditor oversight entities have come so far in recent years that the PCAOB is justified in overturning the clear intent of Congress, when it enacted the Sarbanes-Oxley Act, that the PCAOB provide direct oversight of all audit firms – including foreign firms – that provide audit services to U.S. public companies. As such, this proposal clearly violates the spirit, if not the letter, of the Sarbanes-Oxley Act. If adopted, it would seriously undermine the protections afforded to investors in U.S. listed companies that receive audit services from foreign auditors. We urge the Board to reject this proposed change in policy and to continue instead to rely on joint inspections of foreign audit firms.

I. Background

When Congress adopted the Sarbanes-Oxley Act, it created the Public Company Accounting Oversight Board and charged it with "the oversight of public accounting firms that provide audit services to U.S. public companies, regardless of where the firms are domiciled."[2] Section 106 of the Act specifies that foreign public accounting firms that furnish audit reports with respect to U.S. public companies "shall be subject to this Act and

[1] Consumer Federation of America is a nonprofit association of approximately 300 national, state, and local pro-consumer organizations. It was founded in 1968 to represent the consumer interest through research, education, and advocacy.

[2] PCAOB Release No. 2007-011, Request for Public Comment on Proposed Policy Statement: Guidance Regarding Implementation of PCAOB Rule 4012, December 5, 2007, p. 1.

the rules of the Board and the Commission issued under this Act, in the same manner and to the same extent" as U.S. firms. Congress did not take this position lightly. On the contrary, it insisted on PCAOB oversight of foreign firms in the face of strong opposition and heavy lobbying from foreign governments and regulatory entities. For example, both Sen. Phil Gramm and Rep. Michael Oxley reportedly presented amendments to be considered by the House-Senate conference committee designed to scale back the Act's coverage of foreign accounting firms.[3] The conference committee rejected these changes, insisting instead on the approach taken in the Senate bill.

The reasoning behind this approach can be found in the Senate Banking Committee's legislative report:

> "… the Committee believes that there should be no difference in treatment of a public company's auditors under the bill simply because of a particular auditor's place of operation. Otherwise, a significant loophole in the protection offered U.S. investors would be built into the statutory system. Thus, accounting firms organized under the laws of countries other than the United States that issue audit reports for public companies subject to the U.S. securities laws are covered by the bill in the same manner as domestic accounting firms …"[4]

Elsewhere in the report, the Committee discussed the central importance of independent inspections to the Act's effectiveness. "A robust program of inspections is essential to identify problems in firm procedures, training, and 'culture' before those problems can produce audit failures that trigger large investor losses and threaten confidence in capital markets," the report states.[5]

With more than 800 foreign firms from 86 countries having registered with the PCAOB,[6] however, the PCAOB determined early in its history that it would need to work with foreign regulators, where possible, if it was to fulfill its obligation to provide

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[3] A memo titled "Key Recommended Changes to the Accounting Regulation Bill in Order to Prepare it for Final Enactment," identified as coming from Sen. Phil Gramm, was supplied to the author of this letter by Senate staffers in July of 2002. Among its recommendations was adjusting the bill so as not to "subject foreign accounting firms operating abroad to regulation by the new Board." A memo titled "Additional Protections to be Added," identified as coming from Rep. Michael Oxley, was also supplied to the author of this letter by Senate staffers in July of 2002. That memo included a recommendation to strike Section 106 of the legislation and to require instead that a study be conducted by the SEC, in consultation with the Department of State, international regulatory and accounting bodies, and foreign governments, among others to evaluate whether and to what extent foreign public accounting firms "should be required to register with the Board or otherwise be subject to Board oversight."

[4] Report of the Committee on Banking, Housing and Urban Affairs on the Public Company Accounting Reform and Investor Protection Act of 2002.

[5] Ibid.

[6] PCAOB Release No. 2007-011, pg A1-3-Policy Statement.

meaningful oversight and robust inspections of foreign audit firms under its jurisdiction. In recognition of that fact, the PCAOB adopted Rule 4012 in 2004 laying out the conditions that would allow the Board to use the work of non-U.S. oversight entities in conducting inspections of foreign firms. Under that policy, the Board has developed a program of joint inspections that appears to be working well. This approach, which we support, gives the PCAOB the benefit of home-country expertise and resources while maintaining its ability to fill in any regulatory gaps and focus on compliance with U.S. standards and rules that may differ significantly from those in the home country.

Joint inspections would seem to offer an added benefit that would be lost under a system of full reliance. That is the benefit of greater uniformity in auditing practices and, indirectly, in accounting practices that can result from a consistent approach to inspections. This uniformity will only take on added value if and when more companies begin filing financial statements using International Financial Reporting Standards. Inevitably, that consistency of approach to inspections will be lost under a system of full reliance – particularly if the Board provides as little oversight going forward as this proposal seems to anticipate – and with it the opportunity to drive greater uniformity in the audits and accounting for U.S. public companies.

II. The Board has failed to justify its proposed policy change.

The Board has sought to downplay the significance of its proposal to move to full reliance on non-U.S. oversight entities for the conduct of inspections by characterizing it as simply a further evolution of its approach under Rule 4012. Nothing could be further from the truth. In fact, in adopting Rule 4012 the Board intentionally rejected the approach now being proposed. Although some who commented on its rule proposal urged the Board to "accord complete deference to the home-country regulator" and "rely on the [inspection] report of the non-U.S. regulator," the Board rejected such an approach on the grounds that it would not be in the interest of U.S. investors or the public.[7] As the Board noted in its final rule release:

> "… the Board is required by the Act to conduct inspections in order to assess the registered public accounting firm's compliance with U.S. laws, regulations and professional standards. Because non-U.S. regulatory authorities do not have this same mission, deferring to those authorities regardless of the circumstances would not be in the interests of U.S. investors or the public."[8]

In proposing now to defer to non-U.S. oversight entities that meet certain criteria, the Board offers no justification for this change in policy. It does not, for example, explain why non-U.S. oversight entities can now be relied on to protect ***U.S. investors*** and assess compliance with ***U.S. laws, regulations, and professional standards.*** Instead, the Board has argued that its move is warranted because "the Board has found that it shares a number of objectives with many of its new counterparts such as protecting investors, improving audit

[7] PCAOB Release No. 2004-005, June 9, 2004, Appendix 2, Section-by-Section Analysis of Rules Relating to Oversight of Non-U.S. Firms, p. A2-6.
[8] Ibid, p. A2-6-7.

quality, ensuring effective oversight of audit firms and helping to restore the public trust in the auditing profession."[9] But this is essentially identical to the justification offered by the Board for adopting Rule 4012 in the first place.[10] The Board cannot rely on the same rationale it used for adopting that approach now that it proposes to abandon it. Moreover, as the Board surely knows,"shared objectives" do not guarantee comparable outcomes, which are at least as likely to depend on adequate resources, comparable authority, and a shared compliance culture. In making its case, the Board has an obligation to go beyond vague generalities about shared objectives and provide hard evidence to support its contention that foreign regulators now enjoy resources, authority, and a commitment to compliance comparable to those in the United States.

The Board also suggests in its proposing release that Rule 5113 "reflects the Board's willingness to rely on a non-U.S. oversight entity in connection with an investigation or sanction."[11] But, in contrast to the full reliance now being proposed with regard to inspections, the Board was careful to note in adopting Rule 5113 that it in no way limited its authority to conduct its own investigations or impose its own sanctions.[12] And, just as it did in adopting Rule 4012, the Board specifically rejected a proposal that it defer to the non-U.S. regulator in matters of investigation and sanction.[13] In doing so, the Board restated its concern that non-U.S. regulators do not share the PCAOB's mission of enforcing compliance with U.S. laws, regulations, and standards and noted that such an approach would not be consistent with its obligations under Section 105 of the Sarbanes-Oxley Act.[14]

We realize, of course, that auditor oversight bodies in other countries have continued to evolve since Rules 4012 and 5113 were adopted. The Board provides a brief overview of some of these developments in the proposing release. While this progress is encouraging, we find nothing in the developments described in the release to convince us that these foreign regulators have evolved to such an extent that they can now be relied on to protect U.S. investors and enforce U.S. regulations and standards – something the Board previously determined was not in the public interest and would not be appropriate "regardless of the circumstances." The discussion in the proposing release fails to address this fundamental concern.

The statement of Board Member Charles D. Niemeier in opposition to the proposal strongly suggests that – even if one could get around the concern that non-U.S. regulators do not share the PCAOB's mission of protecting U.S. investors and enforcing compliance with

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[9] PCAOB Release No. 2007-011, p. 1.

[10] The final rule release for Rule 4012 states, for example, that the Board's dialogue with its foreign counterparts "has demonstrated that the Board and its foreign counterparts share many of the same objectives. These include protecting investors from inaccurate financial reporting, improving audit quality, ensuring effective and efficient oversight of accounting firms, and helping to restore the public trust in the auditing profession." PCAOB Release 2004-005, p. 2.

[11] PCAOB Release No. 2007-011, p. A1-5-Policy Statement.

[12] PCAOB Release 2004-005, p. A2-21, Section-by-Section Analysis.

[13] Ibid.

[14] Ibid.

U.S. standards – this proposal would be ill-advised. In explaining his opposition, Mr. Niemeier noted that "few if any countries spend as much on – or devote as much intensity of effort to – enforcement of financial reporting and auditing as the U.S. does."[15] Furthermore, he added, our experience to date has shown that "even the most robust of those other regulators have faced scope limitations and other challenges that we would not countenance."[16] These are serious charges that ought to be addressed by the Board before it proceeds with any proposal to place full reliance on these regulatory bodies. Yet these concerns are also ignored in the proposing release.

In short, this proposal embodies a radical departure from Congress's clearly stated intent that foreign auditors be regulated "in the same manner and to the same extent" as U.S. firms. Moreover, it adopts an approach that the Board previously rejected as not in the interests of U.S. investors, and does so despite evidence that foreign regulators, while they continue to evolve, face limitations of resources and authority that U.S. regulators do not. Because it cannot meet its promise to ensure investors the same level of protections afforded them by direct U.S. oversight, we strongly urge the Board to reject this proposal.

III. The Board has failed to support its contention that non-U.S. oversight entities have evolved to such a degree in recent years that they now offer protections comparable to those Congress intended to provide in the Sarbanes-Oxley Act.

The Board suggests in its proposing release that it has identified "factors relevant to 'full reliance' by the Board on the inspections systems of its non-U.S. counterparts that are sufficiently rigorous to meet the level of protection for investors that is required by the Sarbanes-Oxley Act."[17] We question whether that is the case, particularly with regard to independence (as we will discuss in greater detail below). In addition, the concerns raised by Mr. Niemeier in his statement about adequacy of resources and limitations on authority raise further serious questions about the validity of that contention. Certainly, the Board has provided no hard evidence to support its case. If the Board insists on moving ahead with its full reliance proposal, we believe it must, at an absolute minimum, go back and build the evidentiary basis for its action.

The following are among the questions we believe the Board has an obligation to answer before proceeding.

- **How does the proposal for full reliance comport with requirements under the Sarbanes-Oxley Act that the Board conduct its own inspections, reach its own findings, and issue its own reports?**

Section 104 of the Sarbanes-Oxley Act specifies that the Board is to conduct inspections of registered firms and prepare a written report of its findings with regard to each inspection. Moreover, Section 106 of the Act makes clear that Congress intended these

[15] Statement of Charles D. Niemeier at December 5, 2007 open meeting of the PCAOB "To Consider Proposing Release of Full Reliance Policy Statement."
[16] Ibid.
[17] PCAOB Release No. 2007-011, p. A1-6-Policy Statement.

requirements to apply equally to foreign audit firms engaged in the preparation of the audit reports of U.S. public companies. Neither section appears to anticipate that these responsibilities would be delegated. Yet, the full reliance proposal under consideration anticipates that the Board would not only rely on non-U.S. oversight entities to conduct inspections but would, except in extraordinary circumstances, rely on the findings of the non-U.S. oversight entity, refer to the inspection reports of that entity rather than developing its own reports, and even rely on the foreign regulator to ensure that any quality control problems identified by the inspection are adequately addressed.

While Section 106 of the Sarbanes-Oxley Act gives the Board authority to exempt foreign accounting firms from the Act or from rules of the Board – authority that the Board claims to have relied upon in developing this proposal – the proposal seems to us to exempt not just foreign audit firms but the Board itself from the requirements of the Act. On what basis has the Board determined that it is appropriate to exempt itself from the requirements of the Sarbanes-Oxley Act, in particular the requirements in Section 104 that it conduct inspections of registered firms, develop findings based on those inspections, and issue those findings in the form of a written report?

- **How do those non-U.S. oversight entities the Board anticipates would be eligible for full-reliance in the near term measure up to the requirements of the Sarbanes-Oxley Act?**

The Sarbanes-Oxley Act was quite specific in identifying the factors Congress considered essential to ensure independent and effective oversight of the auditing profession. These include an independent board, independent funding, standard-setting authority, authority to inspect individual audits, and enforcement authority. Moreover, Congress took steps to ensure the Board was funded at a level that allowed it to attract professionals of the highest quality and maintain a robust regulatory program. For each of those entities the Board anticipates are likely to be eligible for full reliance either now or in the near future, the Board should document how they fulfill each of these standards so that members of the public can better assess whether the proposal is justified. Once it has done so, the Board should release that analysis for public review and comment before proceeding with this proposal.

- **On what basis has the Board determined that non-U.S. oversight entities are equipped to enforce compliance with U.S. laws, rules, and standards?**

Under a system of joint inspections, the Board maintains ultimate responsibility for ensuring compliance with U.S. laws, regulations, and standards. Under full reliance, that responsibility would shift to non-U.S. oversight entities. On what basis does the Board expect to determine whether these regulatory bodies have sufficient expertise to justify such an approach? In particular, what degree of familiarity would they be expected to have in U.S. GAAS, including in areas such as standards for audits over internal controls and strict independence rules that may not be replicated in their home country regulations? In addition, what is the basis for the Board's determination that these entities share its commitment to the protection of U.S. investors and the enforcement of U.S. laws and standards?

- **How does the Board plan to ensure on-going compliance by non-U.S. oversight entities with full-reliance eligibility standards, particularly with regard to the rigor of its inspection process?**

Under a system of joint inspections, the Board is able to constantly reassess the degree to which it is appropriate to use the work of a non-U.S. oversight entity. A system of full reliance, as outlined in this proposal, does not appear to offer any comparable mechanism to ensure going forward that the regulator is offering an appropriate level of protection to U.S. investors. How and to what degree does the Board anticipate that negotiated agreements would allow for that oversight and for voiding the agreement should a regulatory body cease to meet requirements for full reliance? As a practical matter, it would seem that such agreements would be very difficult to break, even were serious concerns to arise. How does the Board anticipate this would work should problems emerge at a non-U.S. oversight entity already granted full-reliance status through a negotiated agreement?

Until it can answer these questions, and subject its analysis to public review, we believe the Board should withdraw its proposal and continue to rely on joint inspections. The Board has offered no evidence of a crisis in the current system that would justify a rush to judgment on the current proposal. Indeed, all the evidence seems to suggest that the Board's current program of joint inspections is functioning well. As a result, slowing down the approval process to allow a more thorough documentation and a more careful review would appear to pose no threat to investors, the industry, or the marketplace.

IV. There are serious short-comings in the proposed approach to full reliance.

If, against our strong opposition, the Board were to proceed with this proposal, it would need significant improvements in several areas. These include strengthening of independence requirements for full reliance eligibility, improvements to the process for negotiating full reliance agreements, improvements to the procedures for monitoring inspections conducted under full reliance agreements and continued compliance with the conditions of the full reliance agreement, and elimination of reliance on non-U.S. oversight entities for reaching findings, issuing reports, and remediating problems.

- **The proposal includes inadequate standards to ensure the independence of non-U.S. oversight entities deemed eligible for full reliance.**

Rule 4012 adopts a "sliding scale" for determining the degree of reliance the Board may place on the work of non-U.S. oversight entities, with greater independence resulting in greater reliance. In proposing to move from a system of joint inspections to full reliance, one would expect the Board to strengthen, not weaken the requirements for independence of the non-U.S. oversight entities whose work it proposes to rely on. Instead, the Board's new proposal would allow full reliance with less than full independence. Specifically, it requires only that a "majority of the governing body of the non-U.S. oversight entity must be

comprised of persons who are not current or former accountants or auditors or affiliated with an audit firm or the audit profession."[18]

This is in stark contrast to the strong emphasis Congress placed on independence in establishing the PCAOB. As the Senate Banking Committee noted in its legislative report, it was the view of Congress that "[t]he successful operation of the Board depends on its independence and professionalism." With that in mind, Congress required that only a minority of Board members would have an accountancy background, limited who could chair the Board to non-accountants or those who had been out of the accounting profession for at least five years, required that all Board members have a demonstrated commitment to the interests of investors, and required that they serve full-time and receive no outside payments.

While it is certainly true that there is not a single acceptable way to arrive at the high level of independence the Sarbanes-Oxley Act demands, the proposal does not simply allow for flexibility in attaining that same end. Instead, it proposes to rely fully on non-U.S. oversight entities that do not begin to meet the high independence standard demanded by the Sarbanes-Oxley Act. In doing so, it makes a lie out of the Board's claim to have identified "the factors relevant to 'full reliance' by the Board on the inspections systems of its non-U.S. counterparts that are sufficiently rigorous to meet the level of protection for investors that is required by the Sarbanes-Oxley Act."[19]

Disturbingly, it has even been suggested that these "essential criteria" would be viewed as "benchmarks" rather than as a firm requirement for attaining full reliance status.[20] This interpretation is encouraged by the Board's statements that it would avoid a check-the-box approach and would not necessarily require that each and every criterion be met. While we would certainly agree that meeting all the essential criteria should not guarantee eligibility for full reliance, failure to meet these requirements, including in particular independence requirements, ought to serve as a disqualifier.

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If, against our strong opposition, the Board insists on moving forward with its full-reliance proposal, it must at a minimum clarify that essential criteria are, in fact, essential. It must also strengthen the criteria related to independence in order to ensure that only those non-U.S. oversight entities that meet independence standards comparable to those in the Sarbanes-Oxley Act are deemed eligible for full reliance.

- **The proposal does not allow for an adequate assessment of the non-U.S. oversight entity before committing the Board to moving forward on a full reliance agreement.**

[18] PCAOB Release No. 2007-011, p. A1-13-Policy Statement.
[19] PCAOB Release No. 2007-011, p. A1-6-Policy Statement.
[20] Comment letter of the Auditor Oversight Commission of Germany found at http://www.pcaobus.org/Inspections/Other/2008/PCAOB_Rule_Comments.pdf, p. 3.

According to the proposing release, the Board expects to make a determination of whether a non-U.S. oversight entity is eligible for full reliance based on a "dialogue" in which it becomes familiar with that entity's "structure, operations and approach to inspections."[21] If the Board determines based on that dialogue that the non-U.S. oversight entity is eligible for full reliance, it will negotiate a bilateral agreement "to set forth the anticipated progression toward full reliance, including a provision for joint inspections before full reliance can take effect."[22] In other words, the Board is proposing to negotiate an agreement to move toward full reliance even before it has experience with joint inspections.

The dialogue referred to in the proposal, however "substantial," can provide only a theoretical understanding of the oversight entity's operations. Joint inspections are necessary to provide practical experience and real-world evidence that those inspections operate as advertised. For this reason, we believe it is completely inappropriate for the Board to begin negotiations on a full reliance agreement before it has had significant experience working with the non-U.S. oversight entity in a joint inspection program. Otherwise, the Board could find itself in the untenable position of having negotiated an agreement to move toward full reliance only to find, once it begins joint inspections, that its earlier determination regarding eligibility for full reliance was unfounded. Moreover, once an agreement is negotiated, the pressure to continue moving forward toward full reliance is likely to be intense. This may incline the Board to set aside concerns that stand in the way of that progress, to the detriment of investor protection.

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If, against our strong opposition, the Board insists on moving forward with its full-reliance proposal, it must at the very least defer any determination about a non-U.S. oversight entity's eligibility for full reliance until after it has significant experience in conducting joint inspections with that entity.

- **The proposal does not provide for adequate on-going monitoring either of inspections conducted by non-U.S. oversight entities under a full reliance agreement or of those entities' on-going compliance with conditions of the agreement.**

The proposal relies on a general commitment by the non-U.S. oversight entity to "maintain the essential criteria on an on-going basis" and on "the opportunity for the Board to observe" the entity's inspections of U.S. companies to "ensure that reliance on the non-U.S. oversight entity meets the requirements of section 104 of the Act."[23] However, "observation," as described in the proposal, includes very little of what we would consider to be actual observation. In describing what it means by observation, the proposal states:

[21] PCAOB Release No. 2007-011, p. A1-10-Policy Statement.
[22] Ibid.
[23] PCAOB Release No. 2007-011, p. A1-10-Policy Statement. (See footnote 12.)

> "… in some instances, PCAOB inspectors may simply consult with the non-U.S. oversight entity about its inspection plans or discuss with the non-U.S. inspectors any complicated or material inspection findings relevant to U.S. public companies. In other cases, PCAOB inspectors may request to accompany the non-U.S. inspection team to the audit firm for interviews with key firm personnel. Finally, there may be occasions when the PCAOB would request that the non-U.S. oversight entity allow PCAOB inspectors to review portions of the firm's audit work papers."[24]

We fail to see how such a hands-off approach can claim to "ensure that reliance on the non-U.S. oversight entity meets the requirements of section 104 of the Act."

The proposal provides no assurance that observation will take place, but only that the Board retains the "opportunity" to observe if it so chooses. Moreover, it includes activities in its definition of "observation" that don't appear to provide any real insight into the operations of the inspections. Helping to plan an inspection, for example, provides no evidence regarding what actually happens in the inspection and can hardly be termed to constitute "observation." According to this description, the only real observation would occur if PCAOB inspectors actually accompanied the non-U.S. inspection team and reviewed the audit work papers. The proposal provides no guidance on how likely these more concrete forms of observation would be to occur, however.

The comment letter submitted by the Auditor Oversight Commission of Germany (AOC) suggests that other regulatory bodies may resist meaningful observation.[25] The AOC states categorically that it would only allow joint inspections as a "confidence-building exercise" and would refuse to participate in joint inspections once a full reliance agreement had been reached. "In accordance with a strict interpretation of the phrase "*full* reliance", the PCAOB would have to *fully* rely on the oversight conducted by the AOC and rely on its findings," the letter further elaborates.[26] If German audit oversight authorities feel this free to dictate the terms of any full reliance agreement before the PCAOB has even formally approved its policy statement, one can only imagine how strenuously they would resist any meaningful oversight by the PCAOB once an agreement had been entered into. It certainly suggests that any Board "requests" to participate in the inspection would be flatly denied.

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If, against our strong opposition, the Board insists on moving forward with its full-reliance proposal, it must develop a more robust system for overseeing the inspections of non-U.S. oversight entities that, among other things, ensures PCAOB inspectors unlimited access to audit work papers and unlimited opportunities to participate in those audits. Any oversight system should be at least as rigorous as the program PCAOB would expect of an

[24] Ibid., p. A1-8-Policy Statement.
[25] Comment letter of the Auditor Oversight Commission of Germany, p. 3.
[26] Ibid.

audit firm proposing to rely on the work of another audit firm. It might, for example, include a system of random checks in which the PCAOB would develop a regular schedule for accompanying non-U.S. inspectors and checking work papers of audits subject to inspection. Non-U.S. oversight entities that object to these conditions would be deemed ineligible for full reliance.

- **The proposal allows the Board to evade its responsibility under Section 104 of the Sarbanes-Oxley Act to arrive at its own findings based on inspections of audit firms and publish those findings in a written report.**

Section 104 of the Sarbanes-Oxley Act requires the Board to make "[a] written report of the findings of the Board for each inspection under this section." It is our understanding that this remains the practice of the Board under its current program of joint inspections. Under the full reliance proposal, however, the Board expects to rely on the non-U.S. oversight entity to "make findings based on its fieldwork."[27] It also apparently expects in most instances to satisfy its reporting requirement by simply referring to the report of the non-U.S. oversight entity.[28] While we recognize that the Sarbanes-Oxley Act gives the PCAOB authority to exempt foreign firms from its rules, it is less clear that the Board is free to exempt itself from the requirements of the law, as it appears to do here. At the very least, the Board is violating the spirit of the Sarbanes-Oxley Act when it adopts a system that does not require it to reach its own findings or publish a report of those findings, as the law clearly intends.

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If, against our strong opposition, the Board insists on moving forward with its full-reliance proposal, it should develop an approach that allows it to comply with its obligations under Section 104 of the Sarbanes-Oxley Act to reach its own findings based on inspections and issue its own reports on those findings.

- **The proposal relies inappropriately on non-U.S. oversight entities to ensure remediation of defects in a firm's quality control systems.**

The Board not only proposes to rely on non-U.S. oversight entities to conduct inspections of foreign audit firms, it proposes to rely on them to remediate any quality control defects identified by those inspections. As the Board notes in footnote 15 of the proposed Policy Statement, "barring exceptional circumstances, the PCAOB expects to rely on the non-U.S. oversight entity's remediation determination."[29] Moreover, the Board would encourage discussions about remediation efforts to occur between the audit firm and the non-U.S. oversight entity without any apparent involvement on its part. As the Board notes in footnote 14 of the Policy Statement, "the PCAOB would request that the firm route its

[27] PCAOB Report No. 2007-011, p. A1-8-Policy Statement.
[28] Ibid., p. A1-15-Policy Statement.
[29] Ibid., p. A1-13-Policy Statement.

comments on the report to the PCAOB through the non-U.S. oversight entity."[30] In other words, even where inspections turn up potentially serious problems that could pose real risks to investors in U.S. public companies, the Board proposes to maintain its hands-off approach, taking no active role in most cases in ensuring that those problems are corrected.

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If, against our strong opposition, the Board insists on moving forward with its full-reliance proposal, it must at least insist in direct involvement in any effort to remediate any quality control defects identified in inspection reports to ensure that they are addressed in a way that provides adequate protection to U.S. investors.

V. Conclusion

When Congress adopted the Sarbanes-Oxley Act, it took a clear stand that foreign audit firms involved in providing audit services to U.S. public companies should be regulated in the same manner and to the same extent as U.S. audit firms. It took that position in the face of strong opposition, because it felt that the failure to do so would open up an unacceptable loophole in the investor protections provided by the Act. Among the central responsibilities it imposed on the new regulatory board it established was the obligation to inspect registered firms and issue written reports on its findings based on those inspections.

Now the PCAOB is proposing to renege on its obligation to inspect foreign audit firms and to rely instead on non-U.S. oversight entities to fulfill that function. It is doing so without providing any evidence that this change, which clearly violates the spirit of the Sarbanes-Oxley Act, is needed. Nor has it provided any evidence that non-U.S. oversight entities are equipped to fulfill that responsibility. On the contrary, in statements at the open meeting at which the Board voted to release the proposed Policy Statement, two members of the Board raised serious questions about whether this was the case. Mr. Niemeier, who opposed proceeding with the proposal, suggested that foreign audit oversight bodies typically lack both the funding and the authority granted the PCAOB. While he supported the proposal, Board Member Bill Gradison raised questions about whether foreign regulators were equipped to enforce compliance with U.S. standards with which they may not be familiar. He further suggested that decisions to grant full reliance are likely to be relatively infrequent. We see nothing in the proposal, however, to back that assumption, nor do we believe that it is a view shared by non-U.S. oversight entities hoping to capitalize on this change of policy.

Without evidence that a change in policy is needed, we believe the Board should reject this proposal on the grounds that it violates the spirit, and perhaps the letter, of the Sarbanes-Oxley Act. At the very least, the Board show slow its rush to approval and provide the documentation needed to show that its proposal is warranted and that its previously expressed concerns that such an approach would not be in investors' interest are no longer valid. Only after it has provided that analysis and submitted it for public comment should the Board resume its consideration of the proposal. Should it decide, against our strong

[30] Ibid., p. A1-12-Policy Statement.

opposition, to proceed with this proposal, the Board should at the very least strengthen key provisions. Only by doing so can it live up to its promise of providing a system that ensures the same level of protection accorded investors by the Sarbanes-Oxley Act. We frankly do not believe that goal is attainable, at least not at this time. We know that this proposal does not achieve it.

Respectfully submitted,

Barbara Roper
Director of Investor Protection

cc: PCAOB Chairman Mark W. Olson
PCAOB Board Member Daniel L. Goelzer
PCAOB Board Member Bill Gradison
PCAOB Board Member Charles D. Niemeier
SEC Chairman Christopher Cox
SEC Commissioner Paul S. Atkins
SEC Commissioner Kathleen L. Casey
Senate Banking Committee Chairman Christopher J. Dodd
Senate Banking Committee Ranking Member Richard C. Shelby
Senate Securities Subcommittee Chairman Jack Reed
Senate Securities Subcommittee Ranking Member Wayne Allard
House Financial Services Committee Chairman Barney Frank
House Financial Services Committee Ranking Member Spencer Bachus
House Capital Markets Subcommittee Chairman Paul E. Kanjorski
House Capital Markets Subcommittee Ranking Member Deborah Pryce