United States Senate

COMMITTEE ON
HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS
WASHINGTON, DC 20510-6250

March 5, 2008

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

RE: Proposed Guidance Regarding Implementation of PCAOB Rule 4012
Relating to Oversight of Foreign Accounting Firms that Audit U.S. Public Companies

Dear Members of the Board:

I am writing in opposition to the Public Company Accounting Oversight Board (PCAOB) proposal that seeks to, in effect, allow the Board, in some cases, to relinquish its statutory obligation to inspect foreign accounting firms that audit U.S. public companies in favor of full reliance on inspections conducted by foreign audit oversight entities.

In my roles as Chairman and Ranking Democrat of the U.S. Senate Permanent Subcommittee on Investigations, I have closely followed the establishment of the Board and its efforts to oversee foreign public accounting firms. In 2003, I submitted the enclosed letter to the Board supporting its plans to require foreign public accounting firms to meet the same registration requirements as U.S. firms, comply with the same U.S. auditing standards, and provide the same level of cooperation with Board requests for information. My 2003 letter described multiple instances in which foreign auditors had engaged in disturbing practices requiring vigorous oversight and warned that exempting foreign firms from full PCAOB oversight could undermine the law. Since then, the Board has developed a track record of overseeing foreign public accounting firms, often working in cooperation with home country regulators and sometimes conducting joint inspections. Board Member Charles Niemeier has said that those procedures are working well and are in no need of revision. The Board, however, wishes to increase its reliance on certain foreign audit oversight entities to the point where it can essentially relieve itself of any obligation to conduct its own inspections and make its own findings with respect to some foreign firms.

The proposal under consideration, as described in the PCAOB release, would authorize the Board to determine whether an audit oversight entity in a foreign country meets certain criteria and, if so, to enter into a bilateral agreement with that entity to move toward the Board's "full reliance" on its inspections. The proposal explains that if the Board were to place "full reliance" on a foreign audit oversight entity, it would rely on that entity to plan and execute all inspections of the country's accounting firms that audit U.S. public companies, make findings about those firms' compliance with U.S. laws, regulations, and standards, and evaluate the firms' implementation of any recommended reforms. The PCAOB's role would be reduced to, at most, observing some of the inspections, consulting with the foreign audit oversight entity about U.S. requirements, and on occasion requesting access to a limited number of audit work papers. The PCAOB has indicated that it would rely on the foreign audit oversight entity's findings and recommendations, but retain its obligation to issue firm-specific inspection reports in the United States and, if a firm were to fail to correct specified deficiencies within a year, to disclose both those deficiencies and why the firm's response was inadequate.

The Board's proposal to move towards full reliance on some foreign inspections is ill-advised, because it would weaken the Sarbanes-Oxley Act's oversight requirements, potentially place U.S. firms at a competitive disadvantage, consume significant Board resources without improving audit oversight, and open the door to unintended negative consequences.

The proposal would weaken the Sarbanes-Oxley Act in several ways. First, it would undermine the law's requirement that foreign firms auditing U.S. public companies receive the same oversight as U.S. accounting firms. During the legislative debate over the Sarbanes-Oxley Act, some Members of Congress argued that foreign accounting firms should be exempt from PCAOB oversight and allowed to operate under the supervision of their home regulators. Others countered that such an exemption would create a loophole in the law, allow divergent oversight standards for firms that audit U.S. companies, and potentially place U.S. firms at a competitive disadvantage due to weaker oversight regimes in other countries. This dispute was resolved in Section 106 of the Act which states that foreign public accounting firms "shall be subject to this Act and the rules of the Board and the Commission issued under this Act, in the same manner and to the same extent" as U.S. accounting firms. In other words, U.S. and foreign public accounting firms are to receive equal treatment from the PCAOB, subject to the same inspections, findings, and reports.1 Section 106's plain language does not authorize the Board to delegate its inspection responsibilities to a foreign body, no matter how trustworthy.

The proposal would also weaken the Act by allowing foreign audit oversight entities to determine how to apply U.S. requirements to foreign firms, reducing the role of the PCAOB to that of an observer and consultant. It would reduce as well the oversight role of the Securities and Exchange Commission (SEC) which has no authority over the decisions of a foreign regulator. The probable result would be divergent legal interpretations and oversight practices in multiple countries, with no mechanism to ensure consistency. To the extent that another country were perceived as exercising less vigorous oversight than the PCAOB, it could also place U.S. firms at a competitive disadvantage compared to firms operating in that country, exactly the problem that Section 106 was designed to prevent.

Moreover, the comment letter submitted by the German Auditor Oversight Commission (AOC) demonstrates the Pandora's box of problems that would be opened if the Board were to adopt the proposed approach. Among other comments, the AOC states that, while Germany would permit joint PCAOB-AOC inspections of German firms for a "limited period of time" as a "confidence-building measure," it would "not allow any further joint inspections once a decision

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1 Section 106 does allow the PCOAB to determine to exempt classes of foreign accounting firms from the Act's provisions, but as the proposal indicates, the Board has explicitly decided against exempting any classes of firms from the law's oversight requirements.

as to full reliance had been taken." Instead, the "PCAOB would have to fully rely on the oversight conducted by the AOC and rely on its findings." In short, if it were given full reliance status, Germany seems to indicate that it would object to any independent inspection of a German audit firm by the PCAOB, even if the firm were to consent and even if U.S. investors, the PCAOB, the SEC, or others raised concerns about the firm's operations or the quality of AOC oversight.

The AOC letter states further that "German law does not permit the AOC to publish individual inspection reports" as required by the Sarbanes-Oxley Act, unless the firm being inspected consents to the publication. The AOC letter states: "Consequently, publication in the home country or an agreement for publication by the PCAOB in the USA – the latter might be considered as by-passing the national law – would be critical, not least owing to confidentiality requirements." These and similar comments indicate that if the PCAOB were to adopt the proposal, it would have to expend substantial resources negotiating bilateral agreements with foreign audit oversight entities over how that country's inspections would work and what constraints could be placed on the PCAOB's reporting obligations. The Board would be required to expend these resources without any prospect of strengthening auditor oversight and with the potential of having to contest efforts to weaken its oversight role. While Germany seems to think that the PCAOB has the authority to deviate from the principles and criteria set forth in its existing rules and proposal, in my view, the PCAOB does not have the authority to bargain away its statutory obligations to inspect foreign accounting firms and subject them to the same oversight requirements as U.S. firms that audit U.S. public companies.

A final point is one that was made in the enclosed letter from 2003, about the unintended consequences that could arise if foreign accounting firms in some countries were exempted from direct PCAOB inspections. Suppose that the Board announced a full reliance agreement with a particular foreign country. That announcement could be followed by a sudden increase in the number of accounting firms opening offices in that country and claiming foreign status there. Each of the "Big Four" firms, for example, could open an affiliate organized under the laws of the specified country. U.S. public companies might then decide to switch to those foreign auditors. The PCAOB might find itself suddenly involved in complex, time-consuming determinations over whether a particular auditor qualifies as a foreign company exempt from direct PCAOB inspections. Again, it could be faced with the need to expend significant resources without improving auditor oversight.

The PCAOB has successfully enlisted the cooperation of foreign audit oversight entities in conducting inspections of foreign accounting firms and ensuring that those firms are properly auditing U.S. public companies. That process is apparently working well. While working with foreign regulators to conduct joint inspections is useful, actually delegating the PCAOB's inspection obligations to a foreign regulator would go too far. The Sarbanes-Oxley Act requires the Board to exercise direct oversight authority over all accounting firms that audit U.S. public companies, whether foreign or domestic, and to treat both types of firms equally. As a longtime supporter of the PCAOB's work, I respectfully urge the Board not to adopt the proposed guidance and to continue its current course of action in which it partially, but not fully, relies on foreign audit oversight entities to inspect foreign accounting firms that audit U.S. public companies.

Thank you for this opportunity to comment on this matter.

Sincerely,

Carl Levin

Carl Levin
Chairman
Permanent Subcommittee on Investigations

CL:ejb
Enclosure

cc: PCAOB Chairman Mark W. Olson
PCAOB Board Member Daniel L. Goelzer
PCAOB Board Member Willis D. Gradison, Jr.
PCAOB Board Member Charles D. Niemeier
SEC Chairman Christopher Cox
SEC Commissioner Paul S. Atkins
SEC Commissioner Kathleen L. Casey

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United States Senate

COMMITTEE ON
GOVERNMENTAL AFFAIRS
WASHINGTON, DC 20510-6250

March 21, 2003

Charles M. Niemeier
Acting Chairman
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, D.C. 20006-2803

Dear Mr. Chairman:

I am writing in strong support of the proposal of the Public Company Accounting Oversight Board to require foreign accounting firms seeking to audit corporations trading on U.S. securities exchanges to register with the Board, comply with U.S. auditing standards, and cooperate with Board requests for auditor and client information.

Over the past five years, in my role as Chairman or Ranking Democrat on the U.S. Senate Permanent Subcommittee on Investigations, I have witnessed evidence in several of our investigations of ineffective, uncooperative, and disturbing practices by foreign auditors. In addition, recent events involving Royal Ahold have raised serious concerns about the adequacy of non-U.S. auditing standards and auditor oversight. These factors alone warrant inclusion of foreign firms auditing U.S. publicly traded corporations under the purview of the Board to protect U.S. shareholders and markets. Additional compelling reasons are that granting an exception for foreign auditors would be time-consuming and burdensome, and might encourage U.S. publicly traded corporations to purchase more audit services from abroad, driving audit services beyond the reach of U.S. oversight. The purpose of the Sarbanes-Oxley Act is to increase auditing oversight to restore investor confidence in U.S. securities markets, not push auditing services offshore to jurisdictions where Board oversight would be more difficult to accomplish.

An example of disturbing practices by foreign auditors can be found in the year-long investigation conducted by my Subcommittee staff into the role of correspondent banking in international money laundering. During the course of this investigation, the Subcommittee held hearings and released a five-volume report prepared by my staff. This report raised questions about the quality of auditing in foreign jurisdictions with strong corporate and bank secrecy laws and weak anti-money laundering controls. The report had this to say, for example, about several foreign accounting firms that had been asked questions about financial statements they reviewed or prepared for local banks:

Charles M. Niemeier, Acting Chairman
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"The investigation encountered a number of instances in which accountants in foreign countries refused to provide information about a bank's financial statements they had prepared in the role of a bank receiver or liquidator. Many foreign accountants contracted during the investigation were uncooperative or even hostile when asked for information.

" – The Dominican auditing firm of Moreau Winston & Company, for example, refused to provide any information about the 1998 financial statement of British Trade and Commerce Bank, even though the financial statement was a publicly available document published in the country's official gazette, the firm had certified the statement as accurate, and the statement contained unusual entries that could not be understood without further explanation.

" – A PriceWaterhouseCoopers auditor in Antigua serving as a government-appointed liquidator for Caribbean American Bank (CAB) refused to provide copies of its reports on CAB's liquidation proceedings, even though the reports were filed in court, they were supposed to be publicly available, and the Antiguan government had asked the auditor to provide the information to the investigation.

" – Another Antiguan accounting firm, Pannell Kerr Foster, issued an audited financial statement for Overseas Development Bank and Trust in which the auditor said certain items could not be confirmed because the appropriate information was not available from another bank, American International Bank. Yet Pannell Kerr Foster was also the auditor of American International Bank, with complete access to that bank's financial records.

"The investigation also came across disturbing evidence of possible conflicts of interest involving accountants and the banks they audited, and of incompetent or dishonest accounting practices. In one instance, an accounting firm verified a $300 million item in a balance sheet for British Trade and Commerce Bank that, when challenged by Dominican government officials, has yet to be substantiated. In another instance, an accounting firm approved an offshore bank's financial statements which appear to have concealed indications of insolvency, insider dealing and questionable transactions. In still another instance raising conflict of interest concerns, an accountant responsible for auditing three offshore banks involving the same official provided that bank official with a letter of reference, which the official then used to help one of the banks open a U.S. correspondent account."[1]

While these matters involved foreign accounting firms reviewing the records of local banks and not U.S. publicly traded corporations, this record of poor performance and poor cooperation with U.S. inquiries does not inspire confidence. Moreover, as increasing numbers of companies such as Tyco International and Ingersoll Rand establish headquarters in the Caribbean or other offshore locations, it is possible that foreign auditors could begin providing substantial auditing services to companies with large numbers of American shareholders. These foreign auditors should be required to meet the same auditing standards and operate under the same oversight as auditors based in the United States.

While accounting firms in the Caribbean and other countries around the world have had a tradition of self-regulation, ongoing corporate accounting scandals indicate self-regulation will no longer suffice to ensure investor confidence in corporations trading on U.S. markets. Enactment of the Sarbanes-Oxley Act has begun a new chapter of independent auditor oversight in the United States, but equivalent reforms have not taken place in many other countries. For example, when the Dutch conglomerate Royal Ahold NV announced a $500 million earnings restatement in February 2003, it brought to light the lack of strict auditing standards and oversight in many European countries, even for companies audited by U.S.-based accounting firms such as Deloitte & Touche which audited Royal Ahold. The Netherlands, home of Royal Ahold, has no agency equivalent to the U.S. Securities Exchange Commission (SEC) or any auditor oversight body. According to the European Federation of Accountants, six nations in the European Union do not enforce accounting standards at all. The United Kingdom is apparently closest to the United States in exercising auditor oversight, but one media report noted that "whereas America's Securities and Exchange Commission . . . has made 1,200 companies correct their audited accounts in the past five years, Britain's equivalent, the Financial Reporting Review Panel, has demanded only 15 restatements in the past dozen. It has just one full-time accountant and investigates only if there is a complaint about a company's figures."[2]

Including foreign auditors under the purview of the new Public Company Accounting Oversight Board would, thus, add a much-needed element of auditor oversight for firms reviewing corporations trading in U.S. markets. At the same time, preliminary estimates indicate overseeing these firms would not overextend the Board. Right now, according to the SEC, of the approximately 1,000 accounting firms that sign financial reports submitted to the SEC, only about fifty to one hundred appear to be

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[1] "Role of U.S. Correspondent Banking in International Money Laundering," S.Hrg. 107-84 (March 2001), Volume I, at 313-314.
[2] "Holier than thou," The Economist (2/8/03).

foreign firms. Because foreign auditors currently appear to make up less than 10 percent of the total number of auditing firms reviewing corporations traded in the United States, supervising them should not be beyond the resources of the Board. Making arrangements with foreign oversight bodies where feasible, and setting registration fees sufficient to support needed oversight efforts, would also help ensure this task is manageable.

In contrast, if foreign auditors were to be exempted from Board oversight, an immediate, time-consuming, and difficult task would arise requiring the Board to determine on a case-by-case basis which auditing firms would qualify as "foreign." KPMG, for example, states on its Internet website that KPMG International is a Swiss non-operating association, while other Internet sites locate KPMG headquarters in the Netherlands. Several major U.S. accounting firms operate an international network of affiliated but independent firms, raising a host of questions about which, if any, of these affiliates would qualify for a foreign exemption. Even in the case of foreign firms that share the name of one of the "Big 4" accounting firms in the United States, facts are likely to differ on the extent to which the U.S. firm is legally responsible for the foreign firm's conduct or requires it to adhere to U.S. auditing standards. For example, on the PricewaterhouseCoopers (PWC) website, below the address of each "worldwide location" listed as a PWC office is this disclaimer: "PricewaterhouseCoopers refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity." Each of these PWC offices could undertake to certify the financial statements of one or more corporations trading in the United States and ask the Board to evaluate whether it was sufficiently divorced from its U.S. affiliate to qualify for a foreign exemption. This complex determination would likely consume significant Board resources, without advancing the goals of strengthening auditor oversight or restoring investor confidence in U.S. securities markets.

Finally, exempting foreign auditors might have the unintended consequence of pushing key auditing services abroad beyond the Board's oversight. More than 1,300 foreign companies are now registered to trade shares in U.S. securities markets, and many use foreign accounting firms. Granting foreign auditors an exemption might encourage most or all of these foreign companies to use a local auditor beyond U.S. auditing oversight. This exemption might also encourage U.S. corporations to use foreign-based auditors in order to avoid Board scrutiny. In addition, exempting foreign auditors might encourage some U.S. auditing firms to relocate their operations or headquarters offshore in order to market themselves to companies as free from Board scrutiny. The decision of the consulting firm Accenture, formerly part of Andersen and now domiciled in Bermuda, provides precedent for a professional services firm moving offshore while continuing to market its services to U.S. publicly traded corporations. This exemption might even provide U.S. corporations with another reason to move offshore, since a company relocating its headquarters abroad could claim that this relocation justified its switching to a local, foreign auditor beyond U.S. auditing oversight. Tyco International, a longtime U.S. company that relocated its headquarters to

Bermuda a few years ago, has continued to trade in the United States and market its shares to U.S. shareholders, while undergoing increased scrutiny over possible accounting irregularities. Surely, if we are to achieve the goals of the Sarbanes-Oxley Act, a company like Tyco ought to be required to use an auditor that is fully subject to the auditing standards and oversight of the Public Company Accounting Oversight Board.

The Board's unanimous support for the proposal to require all foreign auditors seeking to audit corporations traded on U.S. securities exchanges to register with the Board and accept its oversight is a crucial step towards returning stability, reliability, and investor confidence to our capital markets. I support this proposal and urge the Board to continue to oppose any efforts to create an exemption for foreign auditors.

Sincerely,

Carl Levin

Carl Levin, Ranking Democrat
Permanent Subcommittee on Investigations

CL:ejb
cc: PCAOB Board Member Kayla J. Gillan
PCAOB Board Member Daniel L. Goelzer
PCAOB Board Member Willis D. Gradison, Jr.
SEC Chairman William H. Donaldson
SEC Commissioner Paul S. Atkins
SEC Commissioner Roel C. Campos
SEC Commissioner Cynthia A. Glassman
SEC Commissioner Harvey J. Goldschmid