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Dear Sir

PwC response to the Professional Oversight Board's consultation on the Regulation of Third Country Auditors

We welcome the opportunity to comment on the Professional Oversight Board's (POB) consultation on the registration of third country auditors – giving effect in the UK to the requirements of the Statutory Audit Directive ('the Directive'). Whilst these provisions may have some effect on UK based statutory auditors they will have a significant impact on other PricewaterhouseCoopers network firms. This response, therefore, reflects the views of the PwC network firms, each of which is a separate and independent legal entity.

It is very unfortunate that after a two year implementation period for these directive requirements the POB is only now able to consult on an approach to regulating third country auditors where the legal requirement, giving effect to these provisions, has already come into force.

In raising this concern we accept that the UK is one of only two Member States to bring forward practical proposals regarding third country auditors and recognising the absence of a final Commission decision on transitional arrangements. We consider that responsibility for the delay should fall, in part, on the European Commission and other Member States.

To avoid unnecessary cost that may make the UK and other Member State capital markets less attractive to overseas companies, we strongly believe the Commission and all Member States should be urgently working towards one harmonised approach with respect to third

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country auditors. In particular, the following principles should be accepted across all Member States:

- An agreed approach to the classification of auditors under either Article 45 or Article 46;
- One registration form for registrations under Article 45 (your reference OTCA) and the transitional arrangements (your reference TTCA);
- One common registration date;
- That sufficient time is provided to allow audit firms to collect registration information; and
- That there is a common period/date for updating registration information.

Paragraph 2.1 of the consultation paper appears to be taking a sensible and pragmatic approach of using the country in which the auditor is located as being the basis for whether its registration falls under article 45, the transitional arrangements or home country rules (in the case of UK based auditors).

However, this approach does not appear to fully comply with Article 2 paragraphs 4 and 5 of the Directive and Section 1241 of the Companies Act 2006, as amended by Statutory Instrument 3494/2007.

If the POB's approach, of basing registration on the location of the auditor and not the country of a company's incorporation, is not adopted across all Member States it has the potential for causing confusion and may increase registration costs, for example, UK registered auditors may be exempted from registering as a third country auditor in the UK but may be required to register in other Member States.

We understand that there is very little information to properly assess the impact of these proposals – the information contained in Annex 3 is based on the country of incorporation of the audited entity rather than the location of the auditor which may, or may not, be the same.

In identifying this issue we accept that no one approach appears to be better than another. What we are attempting to identify are the potential difficulties audit firms and Member State Oversight Bodies may encounter if these issues are not approached in a harmonised way.

We are also concerned about the possible interpretation by regulators of the requirement contained in the draft Commission's decision and duplicated in paragraph 2.8 in the consultation paper for auditors subject to the transitional arrangements to provide 'necessary information' regarding the outcome of their last external inspection.

We suggest that this requirement should not apply to any reports or portions thereof for which local laws prevent disclosure. An example of this would be the US Public Company Accounting Oversight Board (PCAOB) Part 2 inspection report, which is protected from

disclosure to permit the inspected firm to make quality control improvements. In the same way we would not expect a third country oversight body to require any documentation from an EU Oversight body that was also legally protected.

Legislators have good reasons for imposing legal restrictions on the disclosure of documents and information, for example to protect the confidentiality of information as contained in Article 36 of the Directive the UK Government implemented a restriction on the disclosure of information under provisions contained in the 2006 Companies Act[1].

We consider, therefore, that any requests for 'necessary information' should be limited to that which is publicly available.

In response to the specific questions raised in the consultation paper:

Q1 How important is it that the Oversight Board has arrangements in place to accept and process applications (both for full registration and under transitional arrangements) from third country auditors as soon as the Commission Decision on transitional provisions is published (expected to be July)? Or should the Oversight Board allow more time to try to use common format application forms with other Member States from the outset? A realistic date for introducing this is September or October (paragraph 1.28).

For the POB to properly consider responses to this consultation paper, it is unlikely that arrangements are going to be in place until early September 2008 at the earliest. In these circumstances, we support an approach where a harmonised registration form can be agreed amongst Member States. However, as it has taken the Commission and Member States nearly two years to get to the current position, sufficient time must be allowed for audit firms to collect registration information. Of course, if in the judgement of the POB there seems little prospect that a harmonised approach is achievable, then a UK registration form will need to be developed. In these circumstances, we consider that a UK registration system, including all the necessary forms and guidance, should be available from 1 January 2009.

If, through lack of time, auditors find themselves unable to register before the date at which they issue an audit opinion, resulting in that opinion being unacceptable to the UK's listing authority (under rules implementing the third country Directive requirements), this will result in unnecessary cost for business, have an effect on the attractiveness of the UK markets to overseas companies and may result in widespread criticism of the UK profession and regulatory system.

Our recent experience of the creation of a registration process in Japan, for overseas auditors, is that practical problems with the system only surface once the registration

[1] Statutory Instrument 3494/2007 paragraph 8.

process has been set up. We are, therefore, happy to assist the POB with assessing a proper timeframe for the collection of registration information.

Q2 Do you agree with the overall approach to registration and in particular that there should be different requirements for 'transitional' third country auditors and for 'other' third country auditors? What comments do you have on the detailed registration requirements (paragraphs 2.7 to 2.10)?

We note that the draft Commission's decision on transitional arrangements is silent on the need for auditors included within these provisions to register. However, we accept that Article 46 of the Directive allows for Member States to 'disapply or modify' the registration requirements contained in Article 45.

In practical terms we can see little difference in the level of information auditors covered by the transitional arrangements will need to provide whether it is under 'registration' or some other method of lodging the relevant information with the Oversight Body.

With respect to the requirement to provide updated information in a timely manner (paragraph 2.8) we support the use of an annual return (paragraphs 2.16 and 2.17) but would urge that a common annual date is adopted across all Member States for the provision of updated and initial registration information to avoid imposing unnecessary cost.

The draft Commission's decision and the POB consultation document are silent on what is considered to be 'necessary information' regarding the outcome of the last external inspection of the TTCA.

As certain third country jurisdictions have placed legal impediments on the transfer of certain information regarding their external inspections, we do not believe that 'necessary information' should exceed that which is available to the public on the outcomes from external inspection of audit firms. One potential outcome of requiring information for which there are legal impediments is that the Oversight Board will be unable to take advantage of the transitional information resulting in the costs associated with the full registration of third country auditors.

To demonstrate using one jurisdiction where this occurs, the US Public Company Accounting Oversight Board (PCAOB) Part 2 inspection report identifies specific areas for the inspected audit firm to address. With some limited and specific exceptions, there is a statutory prohibition on the PCAOB from sharing these findings with any party apart from the inspected audit firm. The inspected audit firm then has 12 months to address areas identified in the report with failure to resolve those issues resulting in the outstanding findings being included in a report that is available to the public. This is an approach that has been adopted in the Commission's Recommendation of 6 May 2008 on *'external quality assurance for statutory auditors and audit firms auditing public interest entities*[2]*'* (paragraph 20).

[2] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:120:0020:0024:EN:PDF

The purpose of this approach is to promote an efficient dialogue between the Oversight Body and the inspected audit firms (avoiding protracted debate and 'boiler plating' of inspection reports) with the aim of ensuring firms continue to produce high quality audit work as well as protecting audit firms from litigation risk. Whilst the Commission's Recommendation does not have the same legal force, it is apparent that the same reasoning has been adopted across Europe. It would be unfortunate if the POB sought a level of information from third country oversight bodies and/or third country auditors that they were unable to legally produce; resulted in 'boiler plate' inspection reports; or resulted in full registration of the third country auditor.

In considering the list of transitional countries it is apparent that a number of those countries have yet to introduce a system of external inspection of auditors. The impact of this is that many registration applicants, under the transitional rules, will not be able to provide any information regarding their external inspection.

As drafted, the POB proposal implies that failure to provide this information may result in the POB rejecting applications (paragraph 2.9) under the transitional provisions. This approach, if taken, would increase burdens and costs (both for the firms as well as the POB) and does not appear to use the flexibility that is contained in the draft Commission decision[3].

Q3 To what extent should the Oversight Board seek to verify the accuracy and reliability of the information provided to apply for registration; to what extent should it rely on the audit firm to provide accurate information; and in particular should the firm be expected to provide references in support of its statement on good repute? (paragraph 2.11).

Whilst we would support the Oversight Board in obtaining any information it considers necessary to confirm the accuracy of information it has been provided with it is not clear from whom additional information or references would be sought.

We would suggest that this should be considered on a 'case by case' basis. For example, the Oversight Board may consider that it does not need to verify the accuracy and reliability of information that has been provided by an auditor from a recognised network of firms that is either subject to the methodologies of that network and/or is subject to the rules of a professional body.

We can see little benefit in stipulating that an audit firm provides references as to its 'good repute' as we would be surprised if any audit firm, to whom this request was made, would identify any reference who would not provide a positive endorsement.

This appears to be, therefore, a suggestion that would impose cost with little or no benefit.

[3] Article 1 (e) – 'an indication of whether and when the last quality assurance review of the auditor or audit entity was carried out……'

If additional information is required, we consider that it should only be sought from reliable and reputable sources, such as professional bodies.

Q4 What are your comments on the proposals on de-registration (paragraphs 2.12 to 2.13)?

We agree with the approach identified in paragraphs 2.12 and 2.13 as being sensible. However, where an audit firm has responded positively, but not fully, to the steps identified by the Oversight Board a further short period to allow the audit firm to meet those outstanding areas should be granted before a final decision on whether to deregister is taken. The benefit of granting additional time would be to differentiate those third country auditors who are actively trying to deal with the areas identified from those who have taken no steps.

Q5 What are your comments on the approach to external inspections of third country auditors (paragraphs 2.14 to 2.15)?

We fully support the approach of relying on the external inspections of overseas audit firms, where permitted under the transitional arrangements, and inspections of other EU Oversight Bodies for auditors who register under Article 45 of the Directive.

Q6 Do you have any suggestions that we should take into account as we develop more detailed ideas for external monitoring 'other' third country auditors?

We suggest that all of the Member State Oversight Boards should be considering proposals that are proportionate, do not impose unnecessary cost on either audit firms or oversight boards and are effective and efficient.

We expect that the POB will want to avoid sending its audit inspectors to distant foreign countries if it can be avoided. To this end, it may be able to rely on the work of other Oversight Body inspectors while in other instances offering such reliance to other overseas Oversight Bodies. For example, the PCAOB may be willing to carry out inspections on behalf of the POB on audit firms based in a third country where the PCAOB will rely on the POB carrying out inspections in another third country. This approach would avoid the cost of sending inspectors to multiple third countries whilst also reducing the time audit firms are subject to inspection. It may also encourage the development of a harmonised global approach to the inspection process which will reduce complexity and cost.

Q7 What are your comments on the proposed approach to the continuing oversight of third country auditors (paragraphs 2.16 to 2.17)?

We support the use of an annual return for both categories of third country auditor but would draw your attention to our comments to question 2. We fully support the approach for TTCAs outlined in paragraph 2.16.

With respect to the point in paragraph 2.17 of prohibiting a particular audit partner from signing an audit opinion, we trust that the POB is not intending to act without first following a proper process before any prohibition takes effect (see our comments to question 8).

Q8 What are your comments on the proposed approach to investigations and sanctions by the Oversight Board of third country auditors (paragraphs 2.18 to 2.19)?

It is unclear whether what is proposed in paragraph 2.18 would follow the course proposed in paragraph 2.12, namely, that a TTCA has three months to resolve identified issues.

We would be concerned if a TTCA could be de-registered without the opportunity to appeal that decision. This is a particular concern when taking into account the suggestion contained in paragraph 2.16 that *'we will consider taking action where we are made aware of information that calls into question continued registration'*, which does not specify the relevance and reliability of the source of that information.

We believe that any system dealing with the removal of an auditor from the register must be transparent and accountable whether applied to a UK based auditor, an auditor registered under Article 45 or an auditor registered under the transitional arrangements.

Whilst we do not expect that there will be many cases of either TTCA or OTCA auditors being subject to investigations, we suggest that the disciplinary resources of one of the UK Recognised Supervisory Bodies could be utilised to allow a proper hearing of matters.

Q9 Do you have comments or suggestions on the proposed structure of fees? Do you have comments on the proposed level of fees? (paragraphs 2.20 to 2.27)

We can see some benefit in there being a tapering of fees for those with lower numbers of audit clients; what is proposed is that the fee structure is the same for one audit client as it is for nine.

It is likely that there will be a number of auditors with one or two audit clients, and we would suggest that a separation between 0 and 3 clients and 4 to 9 clients should provide a better balance.

Whilst the proposal in paragraph 2.25 of external inspections fees being calculated on a case by case basis appears sensible, we would suggest that it is not compliant with Article 32, paragraph 7, of the Directive which says *'the funding for the public oversight system shall be secure and free from any undue influence by statutory auditors or audit firms'*.

We would suggest that recovering inspection costs via the fee for full registration under Article 45 may be a suitable approach.

Q10 Do you have comments on the assessment of costs and benefits in Chapter 4?

It is unfortunate that the European Commission failed to produce an impact assessment on these requirements and other provisions contained in the 8th Company Law Directive on Statutory Audit in 2004 when the proposed Directive was published.

This failure has significantly reduced the benefit of any impact assessments subsequently produced by the UK Government, in implementing Directive requirements, and the POB in bringing forward secondary legislation and regulations.

Had an impact assessment been carried out on the Article 45 and 46 provisions by the Commission, we consider it likely that they would have identified that investors in overseas companies were well aware of the risks to their investment and, as such, did not need the level of protection these two Articles purport to provide with the increased disproportionate cost.

It is therefore very important that, in implementing these provisions, costs are reduced to a minimum and that there is recognition of the maturity of investor in these companies.

As we have identified previously, and in response to the comments contained in paragraph 4.8, a harmonised approach to the registration and oversight of overseas company auditors will keep additional costs to a minimum and we urge the POB to pursue this approach as a matter of priority with the Commission and EU and non EU oversight bodies.

Q11 Do you have any other comments or suggestions on how we should regulate third country auditors?

We have no other comments.

If you require any further information would you please contact Peter Wyman of this office. We are happy for this response to be published.

Yours faithfully

PricewaterhouseCoopers LLP