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VIA ELECTRONIC FILING

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Jonathan Katz, Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609

File No. PCAOB-2003-03
PCAOB Notice of Filing of Proposed Rules Relating to Registration System

Dear Mr. Katz:

Ernst & Young is pleased to submit comments on the proposal of the Public Company Accounting Oversight Board ("PCAOB") implementing the accounting firm registration requirements of Sections 102 and 106 of the Sarbanes-Oxley Act ("the Act"). We are submitting this comment letter not only on behalf of Ernst & Young LLP, a United States accounting firm, but also on behalf of practices that are affiliated with Ernst & Young throughout the world as members of Ernst & Young Global.[1]

The PCAOB's registration rule, in our view, fairly and reasonably tracks most aspects of the statutory mandate applicable to public accounting firms. The proposal is a significant step in establishing a new regulatory regime for the auditors of SEC registrants. It appropriately reflects the fact that U.S. investors have a right to rely on high-quality financial statement audits no matter where the audit is performed. The PCAOB should have mechanisms to ensure adherence by public accounting firms to high standards of quality, ethics and independence.

The bulk of the controversy relating to the PCAOB's proposal has focused on the PCAOB's foreign firm registration requirements. As the SEC is aware from the Roundtable held by the PCAOB on this issue on March 31, 2003, foreign regulators and foreign accounting firms are uniformly opposed to the foreign firm registration requirement. They have primarily expressed concerns in two areas - the registration requirements conflict with foreign privacy and other non-U.S. legal requirements, and they are contrary to principles of international comity requiring that governments give appropriate deference to the laws and regulatory regimes of other countries.

The PCAOB has made a significant effort to accommodate the first concern by promulgating Rule 2105, which establishes a procedure for foreign firms to be exempted from making certain disclosures in their registration applications. The PCAOB also made many other changes in the application form to alleviate foreign firm concerns. However, issues of international comity remain. We discuss these issues further below.

In addition, we raise issues relating to certain other aspects of the PCAOB's rule that we believe should be addressed in the Commission rule release. None of these issues would require that the Commission make substantive changes to the PCAOB's rule, which in view of the statutorily-imposed deadlines for registration likely would not be feasible at this time. Rather, our concerns relate to the matters needing additional clarification or guidance.

A. **Foreign firm registration issues**

The PCAOB's original rule proposal made no accommodation to foreign firms. It required that foreign firms that prepare or issue, or play a substantial role in the preparation or issuance of, any audit report on financial statements that are filed in the U.S. must register with the PCAOB.

In response, Ernst & Young and many other commenters expressed concern about potential conflicts between the PCAOB's registration requirements and foreign laws. Ernst & Young, together with other major accounting firms, retained the Linklaters law firm to assess foreign law issues raised by the PCAOB proposal. Linklaters examined the laws of seven countries that have a considerable number of foreign private issuers - the United Kingdom, Germany, Mexico, France, Japan, Israel and Switzerland. Linklaters concluded that a number of foreign laws would conflict with the PCAOB's requirements regarding consents to production of information and would prevent the firms from completing all portions of the proposed registration form. These foreign laws relate to data protection, employee privacy, client confidentiality, bank secrecy, and national security.

The PCAOB's proposed rule takes these concerns into account. Rule 2105 provides that a firm may withhold information from its application for registration when submission of the information would cause the applicant to violate non-U.S. laws if, as an attachment to the application, it provides (i) a copy of the relevant portion of the conflicting non-U.S. law; (ii) a legal opinion that submitting the information would cause the applicant to violate the conflicting non-U.S. law; and (iii) an explanation of the applicant's efforts to seek consents or waivers to eliminate the conflict (assuming the foreign law constraint can be waived) and a representation that the applicant was unable to obtain the necessary consent or waiver. 68 Fed. Reg. 35016, 35021.

Rule 2105 appears to alleviate most of the legal impediments to foreign firm registration, and it is a very important amendment to the PCAOB's original proposal. We strongly support it. We do, however, have one important concern about the proposal: it provides for the withholding of information if a legal opinion states that disclosure of the information "would" cause a foreign law violation. Legal opinions, however, are rarely written with such certainty. We would expect that the PCAOB would permit the withholding of information based on an opinion that the disclosure "would likely" violate foreign law.

Assuming the PCAOB allows some flexibility in the wording of foreign legal opinions, Rule 2105 goes far in eliminating foreign law constraints. Foreign firms affiliated with Ernst & Young are nevertheless concerned about international comity.

Foreign firms that are members of Ernst & Young Global, as well as many foreign regulators, believe that registration should not be required. Many foreign countries have developed, or are in the process of developing, their own sophisticated and effective means of regulating the accounting profession, and dual U.S. regulation is unnecessary. Non-U.S. firms also believe that there is a serious question of proportionality - the PCAOB's proposal sweeps almost every significant accounting firm in the world into its regulatory regime, yet only approximately 2.5% of the trading volume of European companies listed on the New York Stock Exchange takes place in the United States. Thus, the vast majority of shareholders in these foreign registrants are not U.S. citizens. The proposal also imposes the PCAOB's considerable array of regulatory controls on firms that may have only a handful of

SEC registrants, or, because of the proposed "substantial role" definition, no SEC registrants at all.

The traditional approach to global securities law regulation has been the negotiation of cooperation agreements between U.S and foreign regulators. Since 1982, the SEC has entered into more than 30 information-sharing arrangements with foreign regulators. This approach has been ratified and facilitated by Congress. In 1988, the SEC proposed, and Congress passed, the International Securities Enforcement Cooperation Act (enacted as Section 6 of the Insider Trading and Securities Fraud Enforcement Act, adding Section 21(a)(2) to the Exchange Act). The Act empowered the SEC to assist a foreign regulator by conducting a formal investigation upon the request of the regulator without regard to whether there was a possible violation of the U.S. laws. In turn, many foreign regulators have obtained the authority to gather information at the SEC's request even though a possible violation of the U.S.'s laws, and not those of the foreign jurisdiction, is the subject of the investigation. More recently, in May 2002, the International Organization of Securities Commissions ("IOSCO") adopted the Multilateral Memorandum of Understanding concerning Consultation and Cooperation and the Exchange of Information. *See* http://www.iosco.org/library/pubdocs/pdf/IOSCOPD126.pdf. Like the memoranda of understanding entered into between the SEC and many foreign regulators, the IOSCO multilateral MOU will assist in international cooperation and information-sharing.

We recognize that the MOU process does not always work perfectly - memoranda of understanding can take a long time to negotiate, foreign regulator counterparts may not be as helpful in producing information as the SEC would like, and persons being investigated may oppose the SEC's requests and challenge them in court. But we believe it is preferable to the unilateral imposition of a worldwide regulatory regime by the United States.

Nevertheless, we understand that the PCAOB believed that it had very little choice in this matter, because Section 106(a) of the Act does require registration of foreign firms that prepare or issue audit opinions filed in the U.S. The PCAOB did have a choice whether to require registration of firms with a "substantial role" in the audit of a U.S. registrant - the Act does not require that result - but in view of the otherwise broad registration requirements under Section 106, the "substantial role" test does not significantly expand the number of foreign firms that will be required to register.

In view of these statutory constraints and the attention this matter has already received, we acknowledge that a foreign firm registration exemption is unlikely. And, notwithstanding their policy disagreements, our foreign firm affiliates are of course prepared to register if necessary.

Nonetheless, we urge the Commission to emphasize to the PCAOB the importance of cooperation with non-U.S. regulators. To its considerable credit, the PCAOB stated in its rule release that is "recognizes that it must be flexible about how registration operates," and that it "is prepared to work with its foreign counterparts to find ways to accomplish the goals of the Act without subjecting foreign firms to unnecessary burdens or conflicting requirements." In keeping with this approach, the PCAOB postponed the registration deadline for foreign firms by 180 days, during which time the PCAOB intends to continue "to explore ways" of working with foreign regulators to reduce burdens and conflicting requirements. The 180-day extension was also provided because it will likely take foreign firms a longer period of time to gather the information needed to complete the registration application. 68 Fed. Reg. 35016, 35030.

In addition, the PCAOB stated that it intends to work with foreign regulators and seek to "find ways to reduce administrative burdens and to provide for coordination in areas where there is a common programmatic interest, such as annual reporting, inspection, and discipline." *Id.* at 35029. This, too, is an enormously important demonstration of the PCAOB's intention to work cooperatively with foreign regulators, to the extent possible. We urge that the Commission reinforce the significance of this objective.

B. **Issues applicable to U.S. and non-U.S. firms:**

1. **Criminal law disclosures; roster of accountants; confidentiality concerns:**

The PCAOB's final rule proposal contains broad requirements relating to disclosure of criminal proceedings. Item 5.1 requires that applicants disclose "any" criminal proceeding in which judgment was entered against the applicant or an "associated person" of the applicant during the five years prior to the application. Also, "pending" criminal proceedings must be disclosed. This means that matters that are unrelated to a person's ability to perform as an auditor - misdemeanors such as driving while intoxicated, reckless endangerment with an automobile, or hundreds of other offenses - will now be publicly disclosed in the application form and available for review by anyone with access to the Internet.

We question whether such a broad disclosure requirement is necessary. It extends much further than the Act itself, which only requires disclosure of "pending" proceedings that arise "in connection with any audit report." *See* Section 102(b)(2)(F) of the Act. It seems reasonable to conclude that the statutory formulation is too narrow - there are indeed many criminal offenses that are unrelated to auditing work that would be relevant to a person's integrity, and therefore to a person's ability to work as a public accountant. But "any" criminal offense is too broad.

Assuming this rule cannot be narrowed at this juncture, we ask the Commission to suggest that the PCAOB provides confidential treatment of all criminal information except that which might be "in connection with any audit report," required under Section 102 of the Act. In Rule 2300(b), the PCAOB has allowed applicants to request confidential treatment of information that (1) has not otherwise been publicly disclosed, and (2) "either (i) contains information reasonably identified by the public accounting firm as proprietary information, or (ii) is protected from public disclosure by applicable laws related to the confidentiality of proprietary, personal, or other information." 68 Fed. Reg. at 35022.

We would hope that Rule 2300 could be used to provide confidential treatment of non-audit-related criminal offenses. On the face of the rule, it is not clear that criminal offenses would meet the standard. Criminal matters generally are public proceedings (although in some instances information about criminal violations might be sealed), and information relating to such proceedings therefore is unlikely to be "protected from public disclosure by applicable laws." On the other hand, although information about criminal convictions typically is publicly available, the direct linkage between a criminal conviction and a person's employment status with a public accounting firm is not something that will have been disclosed previously, so such information arguably "has not otherwise been publicly disclosed." *Id.* In any event, because of uncertainty as to whether this information would be given confidential treatment, we urge that the Commission order the PCAOB that, if this

information must be included in the registration application, the PCAOB should provide confidential treatment for any criminal conviction unless the information is related to an audit report.

For many of the same reasons, we believe that making a complete list of the names of every accountant in the firm publicly and readily available, as required under Item 7.1, will result in an unnecessary intrusion on the personal privacy and safety of our partners and employees. It will almost certainly expose our personnel to nuisances, threats, and miscellaneous unwelcome conduct. For example, mailers of "spam" will easily be able to convert the entire roster of our employees into email addressees, further cluttering email "in-boxes" with unwanted and distracting advertisements and promotions. Headhunters, salesmen, and assorted cranks will have an attractive new list of targets. We see no public policy rationale for making this list public and thereby making our thousands of partners and employees the potential victims of annoyance or misconduct. In our view, the name of an individual accountant might not, standing alone, be proprietary or personal information, but the packaging or aggregation of thousands of names surely is. The Commission should so state in its rule release.

2. **Consent to Cooperate with the Board:**

   Item 8.1 requires that the firm and its associated persons consent to providing testimony or documents in response to "any request" by the Board that is "in furtherance of its authority and responsibilities under the Sarbanes-Oxley Act of 2002." The rule on its face does not contain any "reasonableness" limitation, but the SEC should make clear that the same standards that are applicable to SEC subpoenas apply here as well. Courts have held that, to be enforceable, an SEC subpoena must be "sufficiently limited in scope, relevant in purpose, and specific in directive so that compliance will not be unreasonably burdensome." *SEC v. Arthur Young & Co.*, 584 F.2d 1018, 1024 (D.C. 1978), *cert. denied*, 439 U.S. 1071 (1979). We assume that, notwithstanding the consent form, similar standards would apply here, but the Commission should appropriately make that clear.

3. **Other issues:**

   We and other major accounting firms have raised several other issues with the staff of the PCAOB in recent weeks. We understand that the PCAOB may issue guidance in the form of "Frequently Asked Questions," but that has not occurred as of the date of this letter. Accordingly, we bring these matters to the Commission's attention.

   a. **Investment Company Issuers --** The note to Items 2.1 and 2.2 of Form 1 relating to investment company issuers requires that firms disclose fees "rendered to the issuer, to the issuer's investment adviser . . . and to any entity controlling, controlled by, or under common control with, the adviser that provides ongoing services to the issuer." This approach will result in significant duplicate counting of fees, because a single investment company may be comprised of multiple portfolios with different fiscal year ends. A firm may audit some or all of the portfolios of the investment company registrant.

      We have asked the PCAOB to permit investment company registrants with multiple portfolios to be listed as a single issuer with disclosure of aggregate fee data. Listing each portfolio on the application provides no

meaningful additional information and results in significant duplication of data, as generally the fee data for the investment advisor and its affiliates will be the same for each portfolio.

b. **Proxy Fee Data -** Items 2.1 through 2.3 require disclosure of client fee information. Although the rule does not precisely track existing SEC fee disclosure requirements, we understand that the PCAOB will allow us to use as a starting point the fee data for each issuer that is reported in an issuer's published proxy statement. We are then required to recast as necessary (using our best estimates) the issuer's disclosed fees into the categories stated in the PCAOB's final rule (*i.e.,* fees for audit services, other accounting services, non-audit services).

   In some situations a parent corporation, an issuer that files a proxy statement, may have subsidiaries that are also issuers that do not file proxy statements. In such situations, where we audit both the parent and the subsidiaries, we understand that the PCAOB will allow us to provide the fee data requested at the parent level, based on the disclosed proxy fee data.

c. **Definition of the term "associated persons"** - We have asked that the Board confirm our understanding that the definition of "persons associated with an accounting firm" includes only natural persons.

d. **Section 106(b)(2) of the Act -** Section 106(b)(2) of the Act states that where a U.S. accounting firm "relies upon the opinion of a foreign public accounting firm" it is "deemed (A) to have consented to supplying the audit workpapers of that foreign public accounting firm in response to a request for production by the Board or the Commission; and (B) to have secured the agreement of that foreign public accounting firm to such production, as a condition of its reliance on the opinion of that foreign public accounting firm."

   We are uncertain about two elements of this provision, which the Board did not discuss in its rule release. First, it is not clear whether the word "opinion" in the statute is meant to refer to a formal opinion, or merely an informal advisory statement of the foreign firm. For example, the foreign firm might be relied upon to perform an inventory observation on a subsidiary of a U.S. registrant and report back to the U.S. firm on its findings - that may or may not be an "opinion" under the rule. Second, it is not clear how the Board intends this requirement to work in conjunction with the Rule 2105, which allows foreign firms to limit its consent to production of workpapers where foreign law would prohibit such production. In view of the 180-day time lag between U.S. and foreign firm registration, we do not believe we can obtain foreign firm "consent" when the foreign firms are still determining themselves whether and the extent to which, under their relevant laws, they may provide such consent.

We have asked the PCAOB to provide guidance on these issues and expect to be able to resolve them.

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We appreciate the opportunity to provide these comments, and we would welcome discussion of any points that require further explanation.

Respectfully submitted,

Ernst & Young

cc: Chairman William H. Donaldson
Commissioner Paul S. Atkins
Commissioner Roel C. Campos
Commissioner Cynthia A. Glassman
Commissioner Harvey J. Goldschmid
Scott A. Taub, Deputy Chief Accountant

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1 The Ernst & Young global network comprises a group of independent practices operating in more than 130 countries. Some of the practices have ownership or operational links with others, but otherwise the practices are autonomous and are legally separate from one another. Each practice is separately owned and managed and has no liability for each other's acts.