

January 26, 2004

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

By E-Mail: comments@pcaobus.org

Dear Sir(s):

**Re: PCAOB Rulemaking Docket Matter No. 013
IDW Comments on the PCAOB Proposed Rule Relating to the Oversight
of Non-U.S. Public Accounting Firms**

We would like to thank you for the opportunity to comment on the PCAOB Proposed Rule Relating to the Oversight of Non-U.S. Public Accounting Firms. The Institut der Wirtschaftsprüfer represents approximately 85 % of the German Wirtschaftsprüfer (German Public Auditor) profession. The German profession seeks to comment on the proposals by the PCAOB noted above because this Proposed Rule will directly affect the oversight of significant number of German Wirtschaftsprüfer in the areas of registration, inspections, investigations and adjudications.

We support and share the PCAOB's objective of protecting investors, improving audit quality, ensuring effective and efficient oversight of audit firms to help restore the public trust in the auditing profession and buttress the efficient functioning of the capital markets.

General comments

We understand that the PCAOB has undertaken to address the concerns of non-U.S. public accounting firms in relation to registration, inspection, investigation and adjudication provisions of the Sarbanes-Oxley Act by developing a framework under which the PCAOB can implement the Act's provisions by relying, to an appropriate degree,

on a non-U.S. oversight system. In this respect, we consider the PCAOB's concept of a cooperative framework as a step in the right direction in principle, but based on our reading of the Proposed Rules relating to the oversight of Non-U.S. public accounting firms, we believe that the proposed approach is not cooperative in substance. With respect to inspections, we are unable to determine from the Proposed Rule whether the PCAOB is willing to assess any oversight system in any jurisdiction and determine that it can place full reliance on that system. The Board foresees no circumstances in which it will not play an active role, be it in the selection of audit and review engagements, participation of U.S. experts on quality assurance engagements or the specific evaluation of quality control standards in accordance with PCAOB standards. This is in direct contrast to Proposed Rule 5113 regarding investigations and sanctions, according to which, in certain cases, the Board may rely upon investigations or sanctions executed by a non-U.S. authority.

As we have previously noted in our Comment letter on the Proposed Auditing Standard "Audit Documentation", it is inconsistent for the PCAOB to insist, on the one hand, that its rules, regulations and standards must be applied to SEC registrants and those involved with them throughout the world, but on the other hand to take a narrow US-based view of the environment within which SEC registrants and the auditors of their financial statements operate. In this sense, we believe that the PCAOB's principles for the evaluation of the independence and rigor of a particular home country system appears to be a kind of description of the US oversight system rather than a set of basic principles that take the different forms of oversight systems throughout the world into account. Furthermore, the Proposed Rule leaves so much to the discretion of the PCAOB that there appears to be little certainty as to how the rules will be applied in practice, nor how consistently the rules will be applied between different foreign jurisdictions or even within a particular foreign jurisdiction.

The Proposed Rule also does not clarify how cooperation with national authorities would function in practice – in particular, how the PCAOB would handle potential conflicts in the conduct of inspections and general oversight of foreign accounting firms. The Proposed Rule does not appear to contribute to increasing the transparency and public accountability of the PCAOB's determinations at an international level. We would also like to point out that the current proposal will lead to a considerable burden on accounting firms by making them subject to two systems of oversight. In this case, the assertion that the Proposed Rule will reduce such burdens does not appear to be borne out by its actual content.

Conflicts with Non-U.S. Law

Severe legal conflicts for Non-U.S. public accounting firms will arise from a number of existing rules issued by PCAOB recently – especially from PCAOB Rulemaking Docket Matter No. 006, Inspection of Registered Public Accounting Firms, and

PCAOB Rulemaking Docket Matter No. 005, Rules on Investigations and Adjudications.

A general duty to cooperate and comply with any request of the Board and to provide access to any record in the possession or control of the non-U.S. public accounting firm (Rule 4006) will inevitably lead to legal conflicts concerning confidentiality, data protection, employment, secrecy and national security obligations of accounting firms and their clients under German law. Simply obtaining a waiver from the client will neither release the client nor the auditor from most of these obligations. The same problems will arise if the board may require testimony with respect to any matter or to demand any other document or information in the possession of a registered public accounting firm that the Board considers relevant (Rule 5102 (a), Rule 5103 (a)).

As the Proposed Rules make no provision for exemption, a registered public accounting firm will not be permitted to object to, or not comply with any requests which the PCAOB subsequently may make based on the reason that the request infringes national law. An exemption rule similar to Rule 2105 "Conflicting Non-U.S. Laws" with regard to registration, that allows an applicant to withhold information from its application for registration when submission of such information would cause the applicant to violate a non U.S. law if that information were submitted to the Board is not included with respect to inspections and investigations. As discussed below, until the legal conflicts between U.S. law and German law have been resolved, there needs to be a temporary exemption for German firms with respect to the PCAOB's access to documents and other records of German SEC registrants and their subsidiaries and to the PCAOB's right to testimony and documents from the German auditors of these registrants and subsidiaries.

In our letter dated August 18, 2003 we provided a detailed explanation of such legal impediments currently established within the German Law.

Pursuant to the first paragraph of section B. 4: "Agreed-Upon Work Programs under the Proposed Rule" the PCAOB intends to "weigh heavily the non-U.S. inspecting entity's willingness to agree to an inspection work program". Likewise, according to the second paragraph of section C.: "Board's Proposed Rule on Investigations of Non-U.S. Registered Firms" the PCAOB sets forth that "In addition to the Board's assessment of the circumstances at hand, the application of proposed Rule 5113 may depend on the non-U.S. body's willingness and authority to provide the Board or the Director of Enforcement and Investigations with access to the relevant evidence gathered in its investigations." We would like to point out, that the potential for a non-U.S. public accounting firm or a non-U.S. authority to provide the PCAOB with access to relevant documents or information is not merely a question of 'willingness' of the respective entities to cooperate with the PCAOB but rather governed by legal ob-

ligations, such as data protection laws, legal secrecy, national security, employment or confidentiality obligations, which necessarily makes 'willingness' irrelevant.

Given these legal constraints, which are in part based in the provisions of the German constitution together with court decisions in a constitutional context, we believe that the only feasible solution will be real cooperation with the German government and German regulators. In particular, because it appears that the PCAOB will not be in a legal position to perform inspections on German soil and the limitations on accounting firms' and regulators' ability to transfer audit documentation to either the PCAOB directly or to US accounting firms means that the PCAOB will be left with little choice but to recognize or accredit the oversight and inspection regime as established by government and regulators in Germany. Furthermore, it should be noted that the EU Commission is currently in the process of revising the 8th Directive. The coming revisions are expected to require member states of the EU to establish an oversight structure and system closer both in form and substance to that established in the U.S. On this basis, we suggest that the PCAOB seek further dialogue, both with the EU Commission and with the German government and German regulators.

Specific Comments on Board's Proposed Rules by Section as in the Release

Section A. Board's Proposed Rule on Registration

We appreciate the Board's proposal to amend the Registration Rule 2100 to provide a three-month extension of the registration deadline for foreign public accounting firms. However, the amendment does not resolve the basic problem that certain fundamental issues identified above, e.g. legal conflicts regarding data protection, etc., have not been fully resolved. Each German firm registering with the PCAOB would subject itself to PCAOB rules, while at the same time being unable to comply with them due to national legal restrictions in significant areas.

The PCAOB's Proposal to insert an Exhibit 99.3 to Form 1 which comprises only very basic information about the registrant's home country oversight system is in our opinion of very little help, because this information does not go far beyond the information already required by Item 1.7 of Form 1, and therefore it could easily be left out.

Furthermore, it remains unclear in which circumstances non-U.S. firms are permitted to register via the home country registration entity and what the detailed procedures and prerequisites for this kind of registration process may be – especially with regard to the procedures concerning the cooperation between the home country registration entity and the PCAOB. We assume that further clarification on this point would be helpful.

Section B. Board's Proposed Rule on Inspections for Non-U.S. Registered Firms

Subsection 2. Overview of the Proposed Rule

The Proposed PCAOB Rule 4011 (b) would permit a foreign registered public accounting firm to submit a written petition to the Board requesting an inspection that relies upon an inspection conducted by a home country system. In that petition the non-U.S. public accounting firm should describe in detail the non-U.S. system's laws, rules or other information to assist the Board in evaluating such system's independence and rigor.

The requirement for each individual foreign registered public accounting firm to submit detailed description of the Non-U.S. system's laws rules etc. is neither practicable nor cost-effective; we fail to see any corresponding benefit to the public interest. In our view this requirement for individual firms is in contrast to the PCAOB's intention prescribed on page 8 of the Release, to develop an efficient and effective cooperative arrangement and to allow the Board to allocate it's resources in the most cost-effective manner. Such a cooperative arrangement should be a matter for the PCAOB and the national oversight authorities in any given foreign jurisdiction and not for the individual firms. We consider that the PCAOB would itself be faced with an information overload problem if several individual firms were to submit different descriptions or translations of one and the same system.

We would also like to point out, that it would be difficult for the PCAOB to monitor consistency and quality of the information given by each individual firm. Moreover, this requirement would lead to excessive duplication and cost-intensive efforts on the part of each public accounting firm as well as for the PCAOB. If the PCAOB intends to achieve the requirements of the Act cost-effectively and to minimize unnecessarily duplicative administrative burdens to non-U.S. registered firms, then this specific information requirement should be handled on a jurisdictional basis rather than firm-by-firm. We accept that the description for the individual work-program is best provided by individual firms, but a general description of the inspection- or quality assurance system should be provided on a jurisdictional basis by the relevant oversight authority in those jurisdictions.

We also have serious concerns about Proposed Rule 4011(c) (2) in respect of the PCAOB's intention to take into account "any other information that the Board obtains" without prescribing any corresponding feedback and discussion with the countries appropriate entity or entities regarding this other information. In our opinion, this will lead to unintended uncertainty with regard to the PCAOB's evaluation of any particular system and therefore may be detrimental to the desired cooperative approach. We suggest therefore that the PCAOB should clearly define what is to be understood by "any other information". We also suggest that the PCAOB should be required to

discuss such other information and its influence on the evaluation of and resultant reliance on the non-U.S. system with the appropriate entity or entities thus allowing the opportunity to counter any misunderstandings that may otherwise arise.

Subsection 3. Principles for Determining the Independence and Rigor of a Non-U.S. System under the Proposed Rule

The PCAOB has indicated certain principles to be used in its evaluation of the independence and rigor of a particular home country system. We are concerned, that the examples given of criteria the PCAOB intends to use to assess the adequacy and integrity of the home country system are primarily oriented on the US system for inspections and investigations of U.S. public accounting firms. As the Release paper and Proposed Rules therein are concerned exclusively with the oversight of non-U.S. firms we question whether the application of U.S. system-based criteria is appropriate. In stipulating, for instance, that in its evaluation of the independence of the non-U.S. system's operation from the auditing profession the Board would consider "*whether the individual or individuals with whom the system's decision-making authority resides have been appointed, or otherwise selected, by the government of the non-U.S. jurisdiction*" the PCAOB is very precise, but does not anticipate any adjustments for a non-U.S. system that may differ in certain aspects from these specific requirements. This may not be practicable in certain non-U.S. systems, in which the independence requirement of the individuals responsible for oversight are guaranteed by other means.

We note that the PCAOB's evaluation criteria is largely based on the U.S. System, and suggest that this could undermine the sought after cooperation of all parties. The PCAOB should be prepared to concede, that non-U.S. systems, while different in form and detail from the US-System, could be equally effective and efficient in operation as the US-System. Therefore, we urge the PCAOB to amend the rules and guidance thereon to allow a constructive evaluation of any given oversight system in its entirety and not merely consider whether it complies with the U.S. systems requirements. The proposed approach as currently drafted does not adequately take into account provision for the various forms of regulatory systems resultant from different legal traditions in other countries.

Other criteria the Board will consider in assessing the adequacy and integrity of the non-U.S. system included in the examples are overly vague and non-specific, leaving the PCAOB with considerable scope for discretion, whilst promoting an environment of uncertainty that could impede progress towards the PCAOB's intended goals.

Furthermore the PCAOB deliberations on pages 11 and 12 of the Release focus on ensuring that the auditing and accounting profession will not be over-represented amongst those individuals with whom the system's decision-making authority resides. We support this principle, but we foresee a danger that the PCAOB is focusing solely on the aspect of independence, whilst not addressing the qualification aspect of the responsible persons with decision-making authority within the oversight function. We consider it to be equally important to the effectiveness of any oversight system, that there be an adequate (not necessarily a majority) representation of individuals with current professional experience in the fields of auditing, accounting, ethics and quality control standards. In particular, in consideration of the level of authority and impact of decisions made by these individuals or bodies we stress that sufficient input from individuals possessing technical and practical knowledge in this areas is essential.

Furthermore, we question why the independence criteria listed do not address for example financial, business or personal independence risks.

Subsection 4. Agreed-Upon Programs under the Proposed Rule

Degree of reliance of non-U.S.-systems in accordance with Rule 4011 (c) (2)

From the third paragraph on Page 13, we surmise that the PCAOB generally regards inspection systems that involve the profession as less independent and rigorous than other oversight systems. We do not agree with this assertion because inspection systems administrated by independent bodies or by government, in which (active) members of the profession carry out the field work, can be organized and administered such that the inspection is equal in independence and rigor to those in systems where staff is employed directly by regulators to carry out the inspections.

Accordingly, we encourage the PCAOB to apply its proposed criteria in the assessment of non-U.S. oversight systems individually and in the same way to foreign systems, which include elements of involvement of the profession instead of directly discounting the adequacy and rigor of such systems. The merits of each individual non-U.S.-system must be considered as a whole for the PCAOB to determine the extent to which it can reasonably rely upon that system.

We would like to reemphasize that it is important that the PCAOB resolve the conflict of laws that we have identified before subjecting German accounting firms to the provisions of the proposed Rule.

If you have any questions about our comment letter, we would be pleased to be of assistance to you or to meet with you.

Yours very truly,

A handwritten signature in black ink, appearing to read 'Wolfgang Schaum', written in a cursive style.

Wolfgang Schaum
Executive Director

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