aQyris

14 February 2005

Office of the Secretary,
PCAOB,
1666 K Street NW,
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USA

By e-mail to: comments@pcaobus.org

Re: Public Company Accounting Oversight Board (PCAOB)
Rulemaking Docket Matter No. 17, Proposed Ethics and Independence Rules Concerning Independence, Tax Services, and Contingent Fees

Dear PCAOB Board Members:

I appreciate the opportunity to comment to the Public Company Accounting Oversight Board (the Board) on the Proposed Ethics and Independence Rules Concerning Independence, Tax Services and Contingent Fees (the Proposals). Since these rules will have to be applied not just in the United States but around the world as they affect foreign registrants and overseas subsidiaries (and to some extent affiliates) of all registrants, I would be grateful if you would consider these comments made from an international perspective.

I was until recently a tax partner with a major audit firm and part of my duties included assisting tax practitioners across Central and Eastern Europe to understand and comply with relevant regulations including independence rules applicable to the SEC registered audit clients of the firm. I had come to the conclusion that the existing business model of the major audit firms - where they both audited public interest entities (including SEC registrants) and provided other services, principally tax services, as consultants to that sector of the market - did not serve the interests of the public, their clients or indeed the audit or tax practitioners working for those firms.

I do not believe that the Proposals will have any significant impact on the status quo. To a large extent the market is already ahead of the regulators on this issue and public interest entities are increasingly choosing not to use their auditors for any material non-audit services. This has the unwelcome side-effect of reducing significantly the level of effective competition in the public interest entity audit market, and to some extent the market for international tax services. Whereas this sector might appear to have four major international audit firms to choose from in any circumstance, if - as is often the case - one or two of those firms are being retained in some capacity as consultants, the incumbent auditor may only face competition for replacement from, at most, two other major international audit firms. The strengthening of audit independence standards (as long as these firms continue to provide other services) is therefore only further reinforcing the existing oligopoly in the large scale international audit market.

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The managements of the incumbent firms have an overwhelming interest in the status quo and this is not conducive to the reform of this sector, or to producing the quantum improvements to audit quality which the public deserves. The barriers to entry in the large scale international audit market are significant and this is not a situation where the market can be allowed to take its natural course. Some improvement is gradually occurring as tax practitioners in the major audit firms, increasingly frustrated by the audit independence constrictions on their business, move out to start independent tax consultancies and build their own international tax alliances or join larger law firms expanding their international tax capabilities. New competition in this sector will though surely be resisted by the major audit firms using their existing dominant market positions and the economic power at their disposal.

It might be asked why the major audit firms actually want to continue to provide tax consulting services at all? They will answer (after having already extensively discussed the question among themselves) that their tax practices exist to ensure audit quality. This assertion really does deserve to be examined in detail by the Board.

Although perhaps no longer currently the case in the United States, it should not be forgotten that, in most markets worldwide, audit partners have for long been financially supported from the profits of consultancy services including tax services. The audit mandate itself was for too long a means to an end (i.e. advisory service revenues) and the audit was treated as a commodity to be sold sometimes as a loss leader.

Audit firms do (as they maintain) need to have good tax expertise to be good auditors, but a tax consultant who spends 90% of their time acting as an advocate for clients advancing their interests does not necessarily become a healthy skeptic when participating as a tax expert on audit engagements. Even when they are not effectively auditing their own work, tax consultants participating on a part-time basis in tax reviews on audit engagements will necessarily be reviewing the work through their own consultant filters and may well have advised other clients on structures similar to those found at the audit client which may impact their judgment. Audit quality would, I suggest, be enhanced by audit firms retaining full-time specialist tax auditors rather than using their consultant-minded colleagues to perform the activity on a possibly compromised basis.

The Board in its Proposals has concentrated on some fairly narrow areas of tax practice. The sale of shrink-wrapped tax shelters which lack any business purpose is a vile activity whether these products are supplied to an audit client or any other client for that matter. I would hope that all the major audit firms have now ceased activities in this area. The difficulty is, as always, where to draw the lines around such activities. The Board has chosen to leverage off concepts already known to US tax practitioners through existing IRS rules to define what is ‘aggressive tax planning’.

It should not be forgotten that the Proposals will, if adopted, need to be followed by tax practitioners in audit firms in the remotest corners of the world where registrants’ subsidiaries operate. The ‘more likely than not to be allowed under applicable tax laws’ concept will be very hard to judge in practice in jurisdictions where the rule of

law does not always prevail or where the laws are sometimes almost void for uncertainty. There will be a natural tendency to judge with the benefit of hindsight whether the tax practitioner should have advised on a particular transaction only once the tax administration and tax courts have found against the position taken. In some countries the tax authorities ignore the stated law and the courts have an inclination to support the state against the taxpayer, especially in politicized situations. The proposed standard will therefore cause tax practitioners working for audit firms in such markets a great deal of heartache and may lead them to be unduly conservative in their opinions and merely advise on what they know the authorities will accept. This does not serve the interest of the client who is then receiving tax advice which is impaired by the conflict of interest which the audit firm has as a result of the fear of criticism or sanction under the audit independence rules. It then becomes very difficult for the audit firm to provide truly objective tax advice to its audit clients in such circumstances. This situation also does nothing to promote the rule of law in these jurisdictions.

The Board's justification for continuing to allow auditors of registrants to provide routine tax services to their clients seems to be based principally upon the fact that audit firms have been performing these activities for a long time. It may have been true, even through the 1970's, that the tax practices were an auxiliary and support function of the audit practices in the respective firms performing relatively routine tax compliance tasks. But with the burgeoning consulting culture in the audit firms through the 1980's and 1990's, this is today no longer the case and these tax businesses are substantial in their own right. The four major international audit firms currently share about $15bn of tax business worldwide, less than 15% of which is probably truly in support of their audit businesses. A relatively small amount of this overall turnover is attributable to very routine compliance tasks for public interest entities since it is generally more cost effective for this work to be handled in-house by the companies themselves or outsourced to specialized suppliers. The majority of the tax services provided by the major audit firms therefore have a significant value-added component which is evidenced by the average rates paid for the services. This great middle ground of tax service has not really been addressed in the Proposal where the references made are generally only to the two ends of the scale: abusive tax shelters and routine compliance.

The SEC has prohibited the provision of legal services to registrant audit clients on the grounds that the lawyer is an advocate for his or her client and that role is fundamentally incompatible with the role of auditor. I would submit that the duty of a tax consultant is equally to promote and protect the interests of his or her client and that he or she is as much an advocate as any lawyer. Tax consultants are involved every day in making submissions to tax authorities, negotiating on behalf of their clients and in resolving tax disputes on an administrative level. It is this middle ground which causes tax practitioners in audit firms most difficulty in applying the existing rules and the Proposal really does not do anything to improve that situation. In such circumstances, breaches of independence rules are inevitable. It is, I suggest, illogical to forbid other legal services, but to permit such tax services to be provided to audit clients. To do so solely in the name of tradition (when the existing business model of the major accounting firms has shown itself to be so wanting) really cannot be justified.

The focus on non-audit services provided by audit firms is to some extent a distraction from the real issues of audit quality, but, until such time as the major international audit firms concentrate fully on their prime business, independence issues will continue to divert attention from what the auditors themselves do - or do not do - in the course of their audit work.

The perpetuation of the current business model of the major audit firms is not in the long-term interest of any of the stakeholders either internal or external:

- Audit partners live in fear that someone in their global organization will cause an independence breach on one of their clients and are constrained from proposing audit services to the valued consulting clients of their firms.
- Tax partners struggle to understand what services they can and cannot provide to audit clients under the varying applicable rules internationally and sometimes even have difficulty to identify whether their tax client is connected with an audit client of their network or not. As long as they work in their existing network, they are increasingly constrained from pursuing that part of the public interest entity market which their firm audits.
- Clients consequently have a restricted choice of both auditors and to some extent tax consultants due to regulatory or 'best market practice' imposed audit independence rules.
- And the investing Public still does not yet have a quality financial audit system in which they can truly place reliance.

I would therefore urge the Board to take a fresh look at this subject, ignoring tradition, with a view to adopting a simple rule from an early date that audit firms should not provide any services to their SEC registered audit clients which are not necessary for the fulfillment of their audit mandate.

Secondly, I would encourage the Board, perhaps with other relevant authorities, to examine the competition issues arising as a result of the combination of an already too small number of major international audit firms with the impact of audit independence restrictions (both regulatory and arising from market best practice) and consider whether the interests of the market and the public would be better served by encouraging or forcing some more radical restructuring of these firms.

Yours sincerely,

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