

February 2, 2009

Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington, DC 20006-2803

RE: PCAOB Rulemaking Docket Matter No. 027

Dear PCAOB Board Members and Staff:

Thank you for the opportunity to comment on the Board's Proposed Rule Amendments Concerning the Timing of Certain Inspections of Non-US Firms, and Other Issues Relating to Inspections of Non-US Firms.

The proposed rule amendment addresses three issues. First, it gives the PCAOB (Board) the ability to postpone, for up to one year, certain inspections of foreign registered public accounting firms that the Board was originally scheduled to complete before the end of 2008. Second, it gives the Board the ability to postpone, for up to three years, certain inspections of foreign registered public accounting firms that the Board was originally scheduled to complete before the end of 2009. Third, the Board seeks input on actions it might take when a foreign registered public accounting firm refuses to cooperate with an inspection request because of the firm's concern that such cooperation may violate local law.

In responding to the proposed rule amendment, I consider each issue from the perspective of the PCAOB's mission, "... to oversee the auditors of public companies in order to *protect the interests of investors* and to further the *public interest in the preparation of informative, fair, and independent audit reports*"(my emphasis).

Postponement of Inspections of Foreign Registered Public Accounting Firms Originally Scheduled to be Completed Before the End of 2008

The Board proposes to postpone the inspection of 21 (really 18 due to technical reasons) foreign registered public accounting firms, originally scheduled to be completed by the end of 2008, until the end of 2009. Under existing Board rules, 52 foreign registered public accounting firms were to be inspected for the first time by the end of 2008.

Therefore, the Board is deferring approximately 40 percent of the inspections required to be completed by the end of 2008 by an additional year. The number of firms not inspected on a timely basis is non-trivial, although the one-year deferral is relatively small. Since 2009 has already arrived, the Board's best option is to complete these inspections by the end of this year, which is consistent with the Board's proposal.

Postponement of Inspections of Foreign Registered Public Accounting Firms Originally Scheduled to be Completed Before the End of 2009

The Board proposes to postpone the inspection of 50 foreign registered public accounting firms, originally scheduled to be completed by the end of 2009, for up to three additional years (as late as 2012). Under existing Board rules, 70 foreign registered public accounting firms were to be inspected for the first time by the end of 2009. Therefore, the Board is deferring approximately 70 percent of the inspections required to be completed by the end of 2009 by up to an additional three years. Unlike the previous deferral, which is essentially unavoidable given the passage of time, this decision is not pre-ordained. Moreover, deferring a significant percentage (70%) of the required inspections by a non-trivial number of years (up to three) strikes me as potentially problematic.

The questions that need to be asked are how this deferral protects the interests of investors, and whether this deferral furthers the public interest in the preparation of informative, fair, and independent audit reports. There is both a short-term and an intermediate-term aspect to this decision. In the short-term, it is hard to argue that deferring inspections for up to an additional three years is in either the public interest or in investor interest. This is especially true since the Board, public accounting firm senior executives, and a growing body of academic studies find evidence that the PCAOB inspection process improves audit quality. However, the Board argues that these deferrals are at least partly to accommodate new audit regulators in foreign jurisdictions, and that investors are best served if the PCAOB can collaborate effectively with foreign regulators in conducting inspections of foreign registered public accounting firms.

Chairman Olson's comments at the PCAOB's Open Board Meeting indicate that the Board has sufficient resources to execute its originally planned inspection plan – "... our inspections have not been forestalled due to staffing or other resource constraint. We can meet our inspection goals with our current and projected resources." Given this fact, presumably the only reason to delay inspections due to be completed by the end of 2009 is as a good faith gesture to foreign oversight bodies, and the payoff to U.S. investors is a better working relationship with these foreign oversight bodies which the Board argues will lead to a superior inspection program. The cost of this decision is delayed inspections (by up to three years) and, presumably, a delay in the improvement to audit quality that is reasonably expected to follow from a Board inspection. Is this a good tradeoff for U.S. investors to make? I agree with comments from Board member Steve Harris that this is a "close call", but I would suggest that deferrals beyond 2009 are only reasonable for firms located in those countries that are making a good faith effort to develop strong auditor oversight bodies, preferably patterned closely after the PCAOB,

and that are working expeditiously to coordinate the necessary inspections with the Board. In other cases, no delay should be forthcoming.

I did find it curious that the Board has inspected non-U.S. firms located in Argentina, Australia, Bermuda, Brazil, Canada, Chile, Colombia, Greece, Hong Kong, India, Indonesia, Ireland, Israel, Japan, Kazakhstan, Mexico, New Zealand, Panama, Peru, Singapore, South Africa, South Korea, Taiwan, and the United Kingdom (footnote 9), whereas no firms have been inspected in countries such as Austria, Belgium, the Czech Republic, Denmark, Finland, France, Germany, Hungary, Italy, Luxembourg, Netherlands, Norway, Poland, Portugal, Spain, Sweden, Switzerland, and Turkey (partial list from footnote 10). These two lists reveal that a large number of the non-inspected firms are in Europe. So, I ask – will any delay allow the development of auditor oversight bodies in Europe (and certain other areas) or simply provide additional time for individuals in these countries to lobby for full reliance on foreign inspections (i.e., in such case the PCAOB will never be directly involved in inspecting firms in these countries). If the former, the proposed delay, while regrettable and potentially costly to U.S. investors, represents a reasonable accommodation; if the latter, any delay is not only unwise but it would serve to reward obstructionist behavior, behavior that clearly is at odds with U.S. law and with the best interests of U.S. investors.

The proposed rule amendments include certain provisions designed to minimize any adverse consequences with delaying inspections originally planned to be completed by the end of 2009. First, the Board's inspection plan would focus on inspecting foreign registered public accounting firms based on the size of U.S. clients audited (based on market capitalization). Firms auditing clients that constitute 35 percent of the total market capitalization would be inspected by the end of 2009, and firms auditing clients that constitute 90 percent of the total market capitalization would be inspected by the end of 2010. This plan represents a reasonable accommodation if the Board adopts the proposed three-year inspection delay. In addition, the Board proposes to include on its web site a list of firms not yet inspected within four years of the end of the calendar year when the firm first issued an audit report while registered with the Board. This type of transparency will enable investors to discount, if they deem appropriate, the quality of earnings reported by companies audited by these non-inspected firms. Although companies (and auditors) may oppose this provision, such disclosure is clearly in the best interest of investors. If this disclosure doesn't matter than investors will not react to it. Conversely, if the disclosure does matter, and investors react, than investors were rightly entitled to this information.

Failure of a Foreign Registered Public Accounting Firm to Cooperate with an Inspection Request

The Board seeks comment on how it might proceed when a foreign registered public accounting firm fails to cooperate with an inspection request because of a concern that such cooperation might violate local law. Although firms that fail to cooperate may feel they have little choice, the Board's failure to aggressively address such non-cooperation could lead to regulatory arbitrage. Taken to the extreme, those U.S. companies seeking

maximum ability to manage earnings (alternatively, those companies seeking minimal audit quality) could retain an audit firm located in a jurisdiction that does not permit PCAOB inspections. Such a development would frustrate the Board's attempts to improve financial reporting quality in the U.S.

Foreign registered accounting firms knew they were to be inspected when they registered with the Board, and numerous firms located in a large number of foreign countries have cooperated with PCAOB inspections. If these firms were aware of legal obstacles to complying with PCAOB inspections, they should not have registered with the Board. Moreover, presumably the U.S. Congress was aware of these issues when they passed the Sarbanes-Oxley Act, and yet the law was written to require foreign firms to follow the same PCAOB rules as U.S. firms. Any accommodation for foreign firms should come from Congressional action and not from PCAOB inaction. Failure of a foreign registered accounting firm to permit a Board inspection should lead to PCAOB revocation of the firm's registration. Until such revocation of registration is effective, the Board's proposed disclosures (p. 17) are likely to be effective in providing transparent disclosure to U.S. investors of those firms not inspected due to non-cooperation, including the involvement of these firms in auditing subsidiaries of U.S. domestic firms. Finally, if the Board chooses not to revoke the registration of these firms, it might consider establishing a PCAOB office in certain foreign countries, staffed by foreign nationals, to conduct the necessary inspections, and to charge the incremental costs of staffing these offices to the registered firms located in the country.

Thank you for the opportunity to have commented on the PCAOB's proposal to defer the inspection of certain registered foreign accounting firms.

Sincerely,

A handwritten signature in blue ink that reads "Joseph V. Carcello". The signature is written in a cursive, flowing style.

Joseph V. Carcello
Ernst & Young Professor
Director of Research – Corporate Governance Center