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### I. Background

Under the Sarbanes-Oxley Act of 2002 (the "Act") and PCAOB Rules, it is unlawful for any public accounting firm to prepare or issue an audit report with respect to any issuer or play a substantial role in the preparation or furnishing of any such audit report without being registered with the PCAOB.<sup>2/</sup> For non-U.S. firms, this registration requirement took effect on July 19, 2004.

The Act directs the Board to conduct a continuing program of inspections to assess registered public accounting firms' compliance with certain requirements.<sup>3/</sup> With respect to each registered firm that regularly provides audit reports for 100 or fewer issuers, the Act requires the Board to conduct an inspection at least once every three years.<sup>4/</sup> The Act authorizes the Board to adjust that inspection frequency requirement by rule if the Board finds that a different inspection schedule is consistent with the purposes of the Act, the public interest, and the protection of investors.<sup>5/</sup>

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Release No. 2008-007 (Dec. 4, 2008) (the "Proposing Release"). The Board also adopted on December 4, 2008 a related rule amendment. Rule 4003(f) allows the Board to postpone for up to one year the first inspection of any non-U.S. firm that the Board is otherwise required to conduct by the end of 2008. Because the Board's action with regard to this rule was final, the Board did not seek comment on it. The Securities and Exchange Commission approved Rule 4003(f) on May 28, 2009.

<sup>2/</sup> See Sections 102(a) and 106 of the Act and PCAOB Rule 2100. For these purposes, the term "issuer" is defined by Section 2(a)(7) of the Act and generally encompasses entities that have issued securities that are registered under Section 12 of the Securities Exchange Act of 1934, or that otherwise have certain reporting obligations to the Securities and Exchange Commission, or that have filed registration statements with the Commission that have not yet become effective.

<sup>3/</sup> See Section 104(a) of the Act.

<sup>4/</sup> See Section 104(b)(1)(B) of the Act.

<sup>5/</sup> See Section 104(b)(2) of the Act.

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Inspection frequency requirements adopted by the Board are set out in PCAOB Rule 4003, "Frequency of Inspections."<sup>6/</sup> Under Rule 4003, when a firm issues an audit report while registered,<sup>7/</sup> the Board must conduct an inspection of that firm within a certain number of calendar years following the year of the audit report.<sup>8/</sup>

The Board began a regular cycle of inspections of U.S. firms in 2004 and has conducted 982 such inspections, including annual inspections of the largest firms and two or more inspections of many other firms. Inspections of non-U.S. firms began in 2005, and the Board has inspected 140 non-U.S. firms<sup>9/</sup> located in 26 jurisdictions.<sup>10/</sup>

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<sup>6/</sup> Registered non-U.S. firms are subject to the Act and the Board's rules "in the same manner and to the same extent as" registered U.S. firms (see Section 106(a) of the Act), including the requirement to cooperate in periodic PCAOB inspections.

<sup>7/</sup> Section 2(a)(4) of the Act defines "audit report" to mean, in essence, an audit report with respect to the financial statements of an "issuer," and that is how the term is used in this release.

<sup>8/</sup> In general, if a firm issues audit reports for 100 or fewer issuers in a calendar year, Rule 4003(b) requires that the Board inspect the firm within the following three calendar years. Rule 4003(d), however, provides that the first such inspection of firms that registered in 2003 or 2004 is not required sooner than the fourth calendar year (after the first calendar year in which the firm, while registered, issues an audit report). This release focuses on firms that become subject to Board inspection by virtue of issuing an audit report, but Rules 4003(b) and (d) also describe inspection frequency requirements for firms that play a substantial role in the preparation or furnishing of an audit report (as defined in PCAOB Rule 1001(p)(ii)) but do not issue an audit report. The Board has adopted and submitted for Commission approval amendments that would eliminate the requirement that the Board regularly inspect such firms although the Board will, each year, inspect some such firms.

<sup>9/</sup> The Board has issued reports on 893 of the 1,122 inspections conducted to date, including reports on 44 of the 140 non-U.S. inspections. Reports on the other inspections are in process.

<sup>10/</sup> 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, Norway, Panama, Peru, the Russian Federation, Singapore, South Africa, South Korea, Chinese-Taipei, and the United Kingdom.

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Under Rule 4003's current inspection frequency requirements, there are 129 additional non-U.S. firms in 42 jurisdictions that, by virtue of their having issued audit reports, the Board is currently required to inspect but has not yet inspected.<sup>11/</sup> Those 129 pending "first inspections" of non-U.S. firms (with deadlines ranging from 2009 to 2012 under the existing rule) are in addition to other pending inspections of non-U.S. firms that the Board has already inspected at least once.

The rule amendment that the Board is adopting will affect a portion of those pending first inspections. Specifically, the amendment to Rule 4003 will give the Board the ability to postpone, for up to three years, first inspections that the Board is currently required to conduct before the end of 2009 in jurisdictions where the Board has conducted no inspections before 2009. The amendment does not affect inspection frequency requirements concerning any other first inspections or concerning any second, or later, inspections of a firm.

## II. Inspections of Non-U.S. Firms

The PCAOB has recognized since the outset of its inspection program that inspections of non-U.S. firms pose special issues.<sup>12/</sup> In its oversight of non-U.S. firms, the Board seeks, to the extent reasonably possible, to coordinate and cooperate with local authorities. Since 2003, when the PCAOB began operations, a number of jurisdictions have developed their own auditor oversight authorities with inspection responsibilities or enhanced existing oversight systems.<sup>13/</sup> The Board believes that it is

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<sup>11/</sup> Those 129 firms are located in Argentina, Australia, Austria, Belgium, Canada, Cayman Islands, China, Cyprus, the Czech Republic, Denmark, Finland, France, Germany, Greece, Hong Kong, Hungary, India, Indonesia, Ireland, Israel, Italy, Japan, Kazakhstan, Luxembourg, Malaysia, Netherlands, Norway, Panama, Papua New Guinea, Philippines, Poland, Portugal, the Russian Federation, Singapore, South Korea, Spain, Sweden, Switzerland, Turkey, the United Arab Emirates, the United Kingdom, and Venezuela.

<sup>12/</sup> See Briefing Paper, Oversight of Non-U.S. Public Accounting Firms (October 28, 2003) (hereinafter "Oversight of Non-U.S. Firms"); Final Rules Relating to the Oversight of Non-U.S. Public Accounting Firms, PCAOB Release No. 2004-005 (June 9, 2004).

<sup>13/</sup> In 2006, for instance, the European Union enacted a directive requiring the creation of an effective system of public oversight for statutory auditors and audit firms within each Member State. See The Directive 2006/43/EC of the European Parliament and the Council (May 17, 2006) (the "Eighth Directive"). In addition, among

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in the interests of the public and investors for the Board to develop efficient and effective cooperative arrangements with its non-U.S. counterparts.<sup>14/</sup> In jurisdictions that have their own inspection programs, this may include conducting joint inspections of firms that are subject to both regulators' authority. Indeed, the Board has a specific framework for working cooperatively with its non-U.S. counterparts to conduct joint inspections and, to the extent deemed appropriate by the Board in any particular case, relying on inspection work performed by that counterpart.<sup>15/</sup> PCAOB Rule 4011 permits non-U.S. firms that are subject to Board inspection to formally request that the Board, in conducting its inspection, rely on a non-U.S. inspection to the extent deemed appropriate by the Board. If a Rule 4011 request is made, Rule 4012 provides that the Board will, at an appropriate time before each inspection of the firm, determine the degree, if any, to which the Board may rely on the non-U.S. inspection. Rule 4012 describes aspects of the non-U.S. system that the Board will evaluate in making that determination. Even where the Board does not work with a local regulator to conduct joint inspections, the Board communicates with its counterpart or other local authorities (such as securities regulators or other government agencies and ministries) regarding its inspections to be conducted in the jurisdiction.

In some jurisdictions, the PCAOB's ability to conduct inspections, either by itself or jointly with a local regulator, is complicated by the concerns of local authorities about potential legal obstacles and sovereignty issues. The Board seeks to work with the home-country authorities to try to resolve these and any other concerns.<sup>16/</sup>

The effort involved in attempting to resolve potential conflicts of law, or to evaluate a non-U.S. system in response to a Rule 4011 request, can be substantial. The effort typically involves negotiating the principles of an arrangement for cooperation consistent with the inspection obligations that the Act imposes on the Board. It also

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others, Canada created the Canadian Public Accountability Board, and in Australia, the responsibilities of the Australian Securities and Investments Commission were expanded to include auditor oversight. In Asia, Japan established the Certified Public Accountants and Auditing Oversight Board, South Korea delegated responsibility for auditor oversight to its Financial Supervisory Service, and Singapore established the Accounting and Corporate Regulatory Authority.

<sup>14/</sup> See Oversight of Non-U.S. Firms at 2-3.

<sup>15/</sup> See PCAOB Rules 4011 and 4012; see also Oversight of Non-U.S. Firms at 2-3.

<sup>16/</sup> See Oversight of Non-U.S. Firms at 3.

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involves the Board gaining a detailed understanding of the other jurisdiction's auditor oversight system in order for the Board to determine the degree of reliance it is willing to place on inspection work performed under that system in a particular inspection year. Additional effort is involved in coordinating the scheduling of specific inspections. Where possible, the Board seeks to conduct inspections jointly with local authorities both to take advantage of potential efficiencies and to avoid imposing unnecessary regulatory burdens on firms. Like the PCAOB, several of these other authorities proceed according to inspection frequency requirements. While some of the Board's counterparts are established and have inspection programs, many have only recently begun inspections or are still building up their inspections resources. As a result, synchronizing the inspections schedules of these authorities and the PCAOB's requirements is sometimes difficult.

Notwithstanding these challenges, the Board has so far conducted 140 non-U.S. inspections. Moreover, 61 of those inspections, in six jurisdictions, have been conducted jointly with other auditor oversight authorities, while inspections in 20 jurisdictions have been conducted solely by the PCAOB.<sup>17/</sup>

### **III. Extension of the Deadline for Some 2009 Inspections**

Under existing Rule 4003, there are currently 68 non-U.S. firms that, by virtue of when they first issued audit reports after registering with the PCAOB, the Board is required to inspect for the first time by the end of 2009.<sup>18/</sup> Those firms are located in 36 jurisdictions, including several jurisdictions in which the Board has already conducted first inspections of other firms. Of those firms, 49 are located in 24 jurisdictions where the Board has not conducted any inspections to date. Most of those 24 jurisdictions have or soon will have a local auditor oversight authority with which the Board would seek to work toward cooperative arrangements before conducting inspections. Because of the steps involved in concluding such arrangements and to evaluate the local system (described above), the Board has concerns about proceeding as if that work can be completed for all of the jurisdictions in which the PCAOB has not previously conducted inspections in time to conduct the required inspections by the end of 2009.

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<sup>17/</sup> Joint inspections have been conducted in Australia, Canada, South Korea, Norway, Singapore and the United Kingdom.

<sup>18/</sup> This discussion does not include, or apply to, those 21 non-U.S. firms whose first inspection deadline has been moved from 2008 to 2009 under Rule 4003(f).



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Accordingly, the Board is adopting a new paragraph (g) to Rule 4003 to allow the Board to postpone, for up to three years, the first inspection of any non-U.S. firm that the Board is currently required to conduct by the end of 2009 and that is in a jurisdiction where the Board has not conducted an inspection before 2009.

In determining the schedule for completion of the inspections subject to new paragraph (g), the Board will implement its proposal to sequence these 49 inspections such that certain minimum thresholds will be satisfied in each of the years from 2009 to 2012. The minimum thresholds relate to U.S. market capitalization of firms' issuer audit clients. The Board will begin by ranking the 49 firms according to the total U.S. market capitalization of a firm's foreign private issuer audit clients.<sup>19/</sup> Working from the top of the list (highest U.S. market capitalization total) down, the 49 firms will be distributed over 2009 to 2012 such that, at a minimum, the following criteria are satisfied:

- by the end of 2009, the Board will inspect firms whose combined issuer audit clients' U.S. market capitalization constitutes at least 35 percent of the aggregate U.S. market capitalization of the audit clients of all 49 firms;
- by the end of 2010, the Board will inspect firms whose combined issuer audit clients' U.S. market capitalization constitutes at least 90 percent of that aggregate;
- by the end of 2011, the Board will inspect firms whose combined issuer audit clients' U.S. market capitalization constitutes at least 99.9 percent of that aggregate; and
- the Board will inspect the remaining firms in 2012.<sup>20/</sup>

In addition to meeting those market capitalization thresholds, the Board also will satisfy certain criteria concerning the number of those 49 firms that will be inspected in

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<sup>19/</sup> For purposes of the ranking described here, the Board will use the average monthly market capitalization on which each issuer's share of the Board's 2008 accounting support fee was based. Thus, the market capitalization figure used for the ranking does not include the value of any referred work performed by the firm.

<sup>20/</sup> Under existing provisions of Rule 4003 that are not affected by this amendment, 2012 would also be the deadline for the Board to conduct the second inspection of those of the 49 firms whose first inspection occurs in 2009.

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each year. Specifically, the Board will conduct at least four of the 49 inspections in 2009, at least 11 more in 2010, and at least 14 more in 2011.<sup>21/</sup>

It is important to note that the distribution described above will not operate to prevent an inspection from occurring earlier than called for by the schedule. Any inspection may be moved to an earlier year for a variety of reasons, such as the presence of risk factors (including risk factors relating to referred work<sup>22/</sup> that the firm performs on audits for which it is not the principal auditor), synchronization of schedules with a local regulator for purposes of a joint inspection, or simply the opportunity and the availability of resources to do an inspection earlier (including availability of inspectors with specialized industry knowledge and relevant language skills). In addition, the Board will at least annually review updated market capitalization data and consider whether there have been any changes that warrant moving a particular inspection forward to an earlier year.

Conversely, the Board does not intend to make changes that would move an inspection of one of these 49 firms to a later year than in the initial distribution except as the result of a development relating to the market capitalization of the firm's issuer clients. Specifically, if a firm's issuer audit client market capitalization drops significantly and the firm performs no significant amount of referred work on audits, its inspection might be delayed to a later year. In any event, the Board will not, for any reason, move one of these 49 inspections to a later year than in the initial distribution without publicly describing the change and the reason for it.

In response to the Board's request for comment on the proposed extension of the 2009 inspection deadline, several commenters suggested that the Board exercise its authority under Section 106 of the Act to exempt firms that cannot cooperate with PCAOB inspections due to legal conflicts or sovereignty-based opposition from their local governments. The Board believes that it is not in the interests of investors or the public to exempt non-U.S. firms from the Act's inspection requirement given that the

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<sup>21/</sup> The issuer audit client U.S. market capitalization currently associated with a significant number of the 49 firms is relatively low, and even zero in a number of cases where firms appear to have stopped issuing audit reports for issuers. As a result, approximately 92% of the relevant issuer market capitalization is associated with 15 of the 49 firms.

<sup>22/</sup> Because the PCAOB is still in the process of gathering information about each firm's referred work, the 2009 inspections will not use referred work as a risk factor for purposes of scheduling.



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Board has previously determined not to exempt non-U.S. firms from the Act's registration requirements and given that an inspection is the Board's primary tool of oversight.<sup>23/</sup>

The Board also received several comment letters addressing the length of the proposed extension for certain firms with 2009 deadlines. Some comment letters expressed concern about the inspection delay of up to three years but ultimately expressed qualified support for the Board's decision. These comments urged the Board to permit no further delays and to proceed as described above by sequencing the inspection of firms subject to the extension based on certain thresholds relating to the U.S. market capitalization of firms' issuer audit clients. These comments also supported the Board's suggestion that the Board announce at the beginning of each calendar year until 2012 all of the non-U.S. jurisdictions in which there are firms whose inspection the Board will conduct in that year. Some comments also suggested that the Board should utilize the additional time provided by the proposed extension to enhance its international inspections program, particularly in the areas of risk assessment and pre-inspection planning.

Other comment letters supported the Board's decision to extend the inspection deadlines, but some qualified their support by noting that three years may not be enough time to overcome the legal conflicts and sovereignty concerns in all relevant jurisdictions. Several comments expressed support for the Board's plan to sequence the deferred inspections in time based on the U.S. market capitalization of the firms' clients, but some also noted that this plan did not adequately take into account the varying degree of legal conflicts present in the different jurisdictions and might have the effect of requiring early on during the three year period the inspection of firms in jurisdictions with legal obstacles that cannot be overcome quickly.

As explained above, the Board believes that an extension of up to three years for the relevant firms is the appropriate course. Distributing the affected firms across three years strikes the proper balance between avoiding unnecessary delays in the inspection of registered firms and allowing reasonable time for the Board to continue its efforts to reach cooperative arrangements with the relevant home-country regulators. The Board

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<sup>23/</sup> When it first became operational, the Board considered whether to exempt non-U.S. firms from registration with the Board. The Board determined that exempting non-U.S. firms would not protect the interests of investors or further the public interest given that registration is the predicate to all of the Board's other oversight programs. See Registration System for Public Accounting Firms, PCAOB Release No. 2003-007 (May 6, 2003) at 13.

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believes that any longer or further extension would not be in the interests of investors or the public.

In the Board's view, this adjustment to the inspection frequency requirement is consistent with the purposes of the Act, the public interest, and the protection of investors. The Board believes that its approach to implementing Rules 4011 and 4012, developing cooperative arrangements, and conducting joint inspections with foreign regulators is enhancing the Board's efforts to carry out its inspection responsibilities. There is long-term value in accepting a limited delay in inspections to continue working toward cooperative arrangements where it appears reasonably possible to reach them. As suggested by some comments, the Board also believes that the additional time to conduct certain inspections will have the added benefit of giving the Board more time to continue to enhance its inspection program, particularly in the areas of risk assessment and pre-inspection planning, and the Board intends to do so.

The Board recognizes that some non-U.S. firms may be reluctant to comply with PCAOB inspection demands because of a concern that doing so might violate local law or the sovereignty of their home country. The Board believes that the purposes of the Act, the public interest, and the protection of investors are better served, up to a point, by delaying some of the first inspections to work toward a cooperative resolution than by precipitating legal disputes involving conflicts between U.S. and non-U.S. law that could arise if the Board sought to enforce compliance with its preferred schedule without regard for the concerns of non-U.S. authorities.

The Board does not intend, however, to make any further adjustments to the inspection frequency requirements applicable to firms whose first inspection was due no later than 2009. While the Board will continue to work toward cooperation and coordination with authorities in the relevant jurisdictions, the Board will make inspection demands on the firms early enough in the year in which they are scheduled for inspection according to the above described sequencing to allow the Board to conduct the inspections during that year.

#### **IV. Transparency Concerning International Inspections Program**

In order to provide additional transparency with regard to the Board's international inspections program, the Board has implemented its proposal to announce publicly, near the beginning of each year until 2012, all of the non-U.S. jurisdictions in which there are firms whose inspections the Board will conduct in that year (including, but not limited to, jurisdictions relevant to the 49 inspections discussed above). Once such announcement is made, the Board will not remove a jurisdiction from the list

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unless the Board publicly explains why the schedule has changed with respect to that jurisdiction.<sup>24/</sup>

In addition, because the Board recognizes that investors have an interest in the identity of firms that have not been inspected within the timeframe that investors could reasonably have expected an inspection to occur, the Board intends to implement its proposal to maintain on its web site an up-to-date list of all registered firms that have not yet had their first Board inspection even though more than four years have passed since the end of the calendar year in which they first issued an audit report while registered with the Board.<sup>25/</sup> Inclusion on the list is not an indication that a firm has not cooperated with the Board or is at fault in any way, nor is the list intended as a substitute for action the Board might take in the event that a firm fails to cooperate in an inspection. The list is intended only to provide transparency to the public with regard to delayed inspections.

The Board received a number of comments addressing transparency issues. Several comment letters support the Board's proposal to maintain a list of firms that have not yet been inspected as described above. Two comments suggested that the Board should provide regular (e.g. biannual) updates on the progress it has made in inspecting the 49 firms subject to the extension. Several comment letters asserted that along with listing the firms that have not been inspected, the Board should explain the reason for the failure to conduct the inspection.

Other commenters expressed opposition to the Board's proposed list of firms. Concerns include the possibility that the list would unfairly raise questions about the

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<sup>24/</sup> A list of the non-U.S. jurisdictions in which there are firms that the Board intends to inspect in 2009 is available at:

[http://www.pcaobus.org/Inspections/Other/2009/List\\_of\\_Jurisdictions\\_2009.pdf](http://www.pcaobus.org/Inspections/Other/2009/List_of_Jurisdictions_2009.pdf).

The Board also maintains on its web site a list of those jurisdictions in which there are registered firms that the Board has inspected:

[http://www.pcaobus.org/Inspections/Other/2009/Inspections\\_Non\\_US.pdf](http://www.pcaobus.org/Inspections/Other/2009/Inspections_Non_US.pdf)

The current list of those jurisdictions also is provided in footnote 10 above.

<sup>25/</sup> See PCAOB Rules 4003(b) and 4003(d); see also Amendments to Board Rules Relating to Inspections, PCAOB Release No. 2006-008 (Dec. 19, 2006).

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firms' quality of work even though no inspection has taken place, potentially through no fault of the firm. Some comment letters also suggested that the list could cause a loss of investor confidence in the listed firms' clients or in other audit firms in jurisdictions with firms on the list. Several commenters urged that the proposed list should be accompanied by language explaining that inclusion on the list does not constitute a reflection of the firms' quality of work, and/or that the list should explain the reason for each firm's inclusion on the list.

Several alternatives to the list of firms proposed by the Board were suggested by the comment letters, including (1) listing only the jurisdictions where inspections have not been conducted rather than listing individual firms, (2) listing firms that have been inspected in lieu of firms that have not, or (3) creating a comprehensive list of all firms subject to inspection with three categories – firms that have been inspected and a report has been issued, firms that have been inspected but where no report has been issued yet, and firms that have not been inspected.

As explained above, the Board believes that the expectation created by the Act and the Board's rules as to the frequency of inspections should be addressed through transparency about the Board's progress. However, the Board agrees with those commenters who suggested that a list of uninspected firms could falsely suggest that the listed firms are being uncooperative without any reason or that the quality of their work is poor. The Board therefore intends to preface the list with language clarifying that inclusion on the list is not intended to create any positive or negative inferences about the quality of the firm's audit work, its systems, policies, procedures, practices or conduct, or about the strength of its home-country oversight system.

The Board does not believe that it would be appropriate to provide an explanation for each firm's inclusion on the list. The Board may not be in a position to know all of the reasons for a firm's position with respect to an inspection demand by the Board. In addition, given the possibility of disciplinary proceedings to determine whether a particular firm's conduct violates the Act or PCAOB rules, it would be inappropriate for the Board to comment publicly on the firm's position with respect to an inspection demand. The Board will include in the prefatory language to the list a statement that inclusion on the list should not be construed as supporting any positive or negative inferences about the reason(s) for inclusion on the list.

Further, the Board does not believe that the alternative suggestions to the proposed list of uninspected firms – such as listing jurisdictions where inspections have not taken place or listing firms where inspections *have* been conducted – are sufficiently transparent. In some jurisdictions, some firms may have been inspected within the relevant four-year time period while other firms were not. Listing the relevant jurisdiction

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therefore would misrepresent the inspection status of those firms that were inspected. In addition, the Board does not believe that listing firms that have been inspected, rather than those that have not, would provide the necessary transparency about the fact that other firms were not inspected during the normal timeframe required by the Act and Board rules, as some firms registered with the PCAOB are not currently required to be regularly inspected under the Board's rules.

Finally, the Board agrees with the comments suggesting that the Board should provide biannual updates about the progress it has made in inspecting the 49 firms subject to the amendment to Rule 4003(g). Thus, the Board will announce biannually its progress toward the thresholds described above with respect to the number of firms to be inspected each year and the aggregate market capitalization of firm clients. An additional measure of transparency of the Board's progress in international inspections in general is provided by the Board maintaining a list on its web site of those jurisdictions in which there are registered firms that the Board has already inspected, as noted in footnote 24 above.

### V. Registered Firms' Obligations

As described above, the Board intends to continue its efforts to develop cooperative relationships with its foreign counterparts. However, in light of its statutory obligation, as the Board explained above and in the Proposing Release, it will need to make inspection demands on non-U.S. firms even in circumstances where the sovereignty concerns or legal objections of local authorities have not been overcome. The Board recognizes that, in those circumstances, some non-U.S. firms may be reluctant to comply with PCAOB inspection demands. The Board cannot, however, let the prospect of such refusals dictate delays in the Board's efforts to conduct inspections.

As explained in the Proposing Release, firms must register with the Board in order to engage in certain professional activity directly related to, and affecting, U.S. financial markets, and all registered firms are subject to the Act and the rules of the Board irrespective of their location.<sup>26/</sup> A registered firm is subject to various requirements and conditions, including PCAOB Rule 4006's requirement to cooperate in an inspection. In addition, as reflected in Section 102(b)(3) of the Act, a firm's

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<sup>26/</sup> See Section 106(a)(1) of the Act.

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compliance with Board requests for information is a condition of the continuing effectiveness of the firm's registration with the Board.<sup>27/</sup>

The Board noted in the Proposing Release that a registered firm's failure or refusal to provide requested information is a violation of Rule 4006 and that the Board does not view non-U.S. legal restrictions or the sovereignty concerns of local authorities as a sufficient defense in a Board disciplinary proceeding instituted under Section 105(c) of the Act for failing or refusing to provide information requested in an inspection.

The Proposing Release explained that when a violation of Rule 4006 is established through a disciplinary proceeding in accordance with the Act and the Board's rules, the Board may impose disciplinary sanctions. The Board noted that there is a range of disciplinary and remedial sanctions available to the Board, including revocation of a firm's registration. While the Board's consideration of any actual noncooperation case will be based on the facts of the case, the Board must take into account the importance of the inspection process to the oversight regime established by the Act. Moreover, the Board must be sensitive to the legislative premise reflected in Section 102(b)(3) – that firms that cannot or will not cooperate with Board requests for information should not be registered. That being said, at the same time, the Board recognizes that a refusal to provide information based on non-U.S. legal restrictions or the sovereignty concerns of local authorities implicates considerations not present in other noncooperation circumstances.

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<sup>27/</sup> Section 102(b)(3) requires that a firm's registration application include a statement that the firm consents to cooperate in and comply with Board requests for information and that the firm understands and agrees that such cooperation and compliance is a condition to the continuing effectiveness of the firm's registration with the Board. Some non-U.S. firms, invoking PCAOB Rule 2105, declined to include such statements in their applications on the ground that, because of the possibility that the Board someday might request information that local law would restrict the firm from providing, the firm could not represent in advance that it would comply with every request that the Board might make. As long as certain criteria are satisfied, PCAOB Rule 2105 allows a firm's registration application to be considered complete, for purposes of registering the firm, even in the absence of the consent to cooperate. The absence from the application of the broad consent to cooperate, however, does not absolve a firm of the underlying obligation to cooperate if and when the Board seeks information, a point that the Board conveys in writing to any such firm when notifying the firm that its application is approved. See also Final Rules Relating to the Oversight of Non-U.S. Public Accounting Firms, PCAOB Release No. 2004-005 (June 9, 2004) at A2-15 – A2-19.



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To assist the Board in its consideration of these issues, the Board invited the public to comment on whether and how a non-U.S. legal restriction or refusal to cooperate due to a sovereignty concern should be factored into the Board's consideration of the appropriate sanction to impose for a violation of Rule 4006.

A number of comment letters urged the Board to adopt meaningful sanctions, including revoking a firm's registration, for non-compliance with Board inspection demands, even if the non-compliance is due to legal conflicts faced by the non-U.S. firm. These comments stated that investors have an interest in the inspections of audit firms who audit, or play a substantial role in the audits of, U.S. issuers and that investors would not benefit from the imposition of weaker sanctions on firms that do not cooperate with PCAOB inspection demands. Several comments stated that weak sanctions in this situation would create an incentive for firms to refuse to cooperate with the PCAOB and could lead to regulatory arbitrage, frustrating the Board's efforts to improve the quality of financial reporting in the U.S. These comments asked the Board to make a clear statement that sanctions will be pursued for non-compliance with inspections.

Conversely, a number of other commenters expressed concerns about the Board sanctioning firms whose refusals to cooperate with Board inspection demands are based on legal conflicts in the firms' respective home jurisdictions. These comments argued that sanctions in that situation would be unfair to the firms who have no control over local legal obstacles and who would be forced to choose between violating the Act and violating their home-country law. On the other hand, several comments stated that this fairness argument inappropriately elevates the concerns of firms over those of investors, who have a right to expect that those firms that play a significant role in the audits of U.S. public companies are subject to oversight on the same terms and to the same degree as U.S. firms.

Several comment letters also expressed concern that the imposition by the PCAOB of sanctions in this situation will harm the relationship of the PCAOB with the non-U.S. jurisdictions whose laws give rise to the conflict. Other comments suggested that the sanctions would impact not only audit firms but also U.S. issuers or their subsidiaries, because, according to the commenters, the sanctions referenced by the Board in the Proposing Release (restricting firms from accepting new clients or revoking firm registrations) would have to be imposed on all firms in a jurisdiction with a conflicting law and would leave available no registered firm to perform the necessary audit work, particularly in jurisdictions where the law requires that local firms perform the relevant audit work.

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The Board appreciates the comments submitted on this point. As previously stated, the Board believes that most, if not all, legal conflicts relating to inspections can be resolved through cooperative arrangements, consents, or redaction of certain types of information that is otherwise not relevant to the inspection. Should a conflict prove to be unsolvable, however, the Board does not believe it would protect the interests of investors or further the public interest for the Board to decline as a matter of general policy to impose any sanctions on firms that do not cooperate with the Board's inspection demands because of legal conflicts or sovereignty concerns. Doing so would be tantamount to exempting those firms from the inspection requirement. The Board ultimately will weigh each case on its facts and will consider the comments further if and when the issue arises in a particular case.<sup>28/</sup>

On the 25th day of June, in the year 2009, the foregoing was, in accordance with the bylaws of the Public Company Accounting Oversight Board,

ADOPTED BY THE BOARD.

/s/ J. Gordon Seymour

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J. Gordon Seymour  
Secretary

June 25, 2009

APPENDIX A –  
Amendment to PCAOB Rule 4003

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<sup>28/</sup> The Board also requested comment on a possible rulemaking approach with regard to disclosures by a principal auditor that would be triggered in the case of noncooperation with a PCAOB inspection demand. The Board has made no final decision on this issue and will continue to consider the comments received in determining whether to undertake rulemaking in this area.

**RELEASE**

**Appendix A – Amendment to Rule 4003**

The Board is amending Section 4 of its rules by amending Rule 4003. The relevant portion of the rule, as amended, is set out below. Language added by the amendments is shown in bold italics. Other text in Section 4, including notes to the Rules, remains unchanged and is indicated by " \* \* \* " in the text below.

**RULES OF THE BOARD**

\* \* \*

**SECTION 4. INSPECTIONS**

\* \* \*

**Rule 4003. Frequency of Inspections**

\* \* \*

***(g) With respect to any foreign registered public accounting firm concerning which the preceding provisions of this Rule, other than paragraphs (a) and (f), would set a 2009 deadline for the first Board inspection and that is headquartered in a country in which no foreign registered public accounting firm that the Board inspected before 2009 is headquartered, such deadline is extended to 2012, provided, however, that from among the group of all such firms, the Board shall conduct some first inspections in each of the years from 2009 to 2012, scheduled according to such criteria as the Board shall publicly announce.***