United States Senate

COMMITTEE ON
HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS

WASHINGTON, DC 20510–6250

February 3, 2014

Via Electronic Submission (comments@pcaobus.org)

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

RE: PCAOB Rulemaking Docket No. 29 on Disclosing Audit Engagement Partners

Dear Members of the Board:

The purpose of this letter is to express support for the proposal by the Public Company Accounting Oversight Board (PCAOB) to improve audit quality, transparency, and accountability by requiring registered public accounting firms to disclose the name of the lead engagement partner in each audit report as well as the name of any other independent public accounting firm that took part in the audit.[1] This letter also urges the Board to reinstate two key transparency measures dropped from its 2011 proposal, requirements that annual reports filed with the PCAOB disclose audit engagement partner names and that public audit reports identify by name all third party audit participants that performed substantial work. In addition, this letter supports requiring engagement partners to sign the audit reports for which they are responsible.

Strengthening Public Company Audits. The U.S. Senate Permanent Subcommittee on Investigations, where we served until recently as Chairman and Ranking Minority Member, has long had an interest in strengthening audits of publicly traded corporations to protect investors, prevent fraud, and provide a strong foundation for the American economy. Our investigations have included exposing the poor quality audits that contributed to the collapse of the Enron Corporation,[2] the development and sale of financial products designed to help corporations hide debt on their financial statements,[3] and the development and sale of abusive tax shelter and other schemes by accounting firms and other professionals to minimize corporate taxes and inflate corporate earnings.[4] The Subcommittee's work has contributed to legislative efforts to

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[1] See PCAOB Release No. 2013-009, "Improving the Transparency of Audits: Proposed Amendments to PCAOB Auditing Standards to Provide Disclosure in the Auditor's Report of Certain Participants in the Audit" (Dec. 4, 2013), PCAOB Rulemaking Docket Matter No. 029 (hereinafter "PCAOB Release No. 2013-009").

[2] See "The Role of the Board of Directors in Enron's Collapse," S. Hrg. 107-511 (May 7, 2002).

[3] See "The Role of the Financial Institutions in Enron's Collapse," S. Hrg. 107-618 (July 23 and 30, 2002).

[4] See, e.g., "U.S. Tax Shelter Industry: The Role of Accountants, Lawyers, and Financial Professionals," S. Hrg. 108-473 (Nov. 18 and 20, 2003); "Tax Haven Abuses: The Enablers, The Tools and Secrecy," S. Hrg. 109-797 (Aug. 1, 2006) (case histories involving the POINT strategy and Kurt Greaves); "Offshore Profit Shifting and the

strengthen the auditing process, including the Sarbanes-Oxley reforms that created the PCAOB, imposed new requirements to ensure auditor independence, and strengthened corporate board oversight of auditing procedures.[5]

Poor quality audits of publicly traded corporations continue to plague the U.S. investment community, allowing misleading accounting, outright frauds, and substantial losses to occur. Egregious examples include Lehman Brothers Holdings Inc., whose bankruptcy disclosed that its auditor, Ernst & Young, approved financial statements that misrepresented its financial condition, including by mischaracterizing the status of $50 billion in assets;[6] Longtop Financial Technologies Ltd., where a Chinese affiliate of Deloitte Touche approved financial statements which it later determined contained numerous indicia of financial fraud;[7] Olympus Corp., where KPMG and Ernst & Young affiliates in Japan approved financial statements that omitted $1.7 billion in losses;[8] and Satyam Computer Services Ltd., where a PricewaterhouseCoopers affiliate approved financial statements in which the company reported years of inflated assets and cash balances.[9]

The SEC has also instituted proceedings against the Chinese affiliates of five major U.S. auditors for refusing to produce audit work papers related to financial statements approved for nine U.S. publicly traded corporations now suspected of accounting fraud.[10] An SEC administrative law judge recently censured all five Chinese firms and ordered four suspended from practicing before the agency for six months.[11] Those cases are on top of older accounting scandals involving prominent public corporations like Enron, WorldCom, Xerox, and Adelphia.[12] These audit failures indicate that more needs to be done to encourage accurate and effective audits of public corporations and increase accountability for poor auditing practices.

U.S. Tax Code – Part 1 (Microsoft and Hewlett-Packard)," S. Hrg. 112-781 (Sept. 20, 2012) (case history on Hewlett-Packard's use of serial, short term loans to repatriate offshore income without paying U.S. taxes).

[5] See Sarbanes-Oxley Act of 2002, P.L. 107-204.

[6] See In re Leman Brothers Holdings Inc., Chapter 11 Case No. 08-13555 (JMP) (US Bankruptcy Court SDNY), Report of Anton R. Valukas, Examiner (March 11, 2010), at 5-8 (including discussion of "Repo 105"), http://jenner.com/lehman/lehman/VOLUME%201.pdf.

[7] See, e.g., SEC v. Deloitte Touche Tohmatsu CPA Ltd., Case No. 1:11-MC-00512 (D.D.C. filed Sept. 8, 2011); In re Longtop Financial Technologies Ltd., Case No. 3-14622 (Nov. 10, 2011), http://www.sec.gov/litigation/admin/2011/34-65734.pdf.

[8] See, e.g., U.S. v. Chan Ming Fon, Case No. No. 13-CR-00052 (LTS)(USDC SDNY), Information, http://www.justice.gov/usao/nys/pressreleases/September13/ChanMingFonPlea/U.S.%20v.%20Chan%20Ming%20Fon%20Information.pdf; "Ex-Banker Pleads Guilty in Olympus Accounting Fraud," Reuters (Sept. 18, 2013), http://www.reuters.com/article/2013/09/18/us-olympus-banker-plea-idUSBRE98H0YE20130918.

[9] See, e.g., SEC v. Satyam Computer Services Ltd., Case No. 1:11-cv-00672 (D.D.C. assigned Apr. 5, 2011), SEC complaint, http://www.sec.gov/litigation/complaints/2011/comp21915.pdf; "Satyam: Not The Only Case PwC Worried About," Accounting Watchdog (Aug. 5, 2011), http://www.forbes.com/sites/francinemckenna/2011/08/05/satyam-not-the-only-case-pwc-worried-about/.

[10] In re BDO China Dahua CPA Co., Ltd., Ernst & Young Hua Ming LLP, KPMG Huazhen (Special General Partnership), Deloitte Touche Tohmatsu CPA Ltd., PricewaterhouseCoopers Zhong Tian CPAs Ltd., Administrative Proceeding File No. 3-15116 (SEC Dec. 3, 2012), SEC Order Instituting Administrative Proceedings Pursuant to Rule 102(e)(1)(iii) of the Commission's Rules of Practice and Notice of Hearing.

[11] In re BDO China Dahua CPA Co., Ltd., Ernst & Young Hua Ming LLP, KPMG Huazhen (Special General Partnership), Deloitte Touche Tohmatsu CPA Ltd., PricewaterhouseCoopers Zhong Tian CPAs Ltd., Administrative Proceeding File Nos. 3-14872, 3-15116 (SEC Jan. 22, 2014), Initial Decision (Public).

[12] See, e.g., Sen. Levin Remarks, Cong. Rec. S6563 (July 10, 2002).

A. PCAOB Proposal

In 2009, in a bid to strengthen audit quality, transparency, and accountability, the PCAOB issued a Concept Release seeking comment on whether auditors should require the engagement partner with final responsibility for a particular audit to sign the audit report. The engagement partner is the key person within a registered public accounting firm who is "responsible for the engagement and its performance," and who coordinates and oversees the audit work and issuance of the audit report.[13]

After receiving multiple comments, two years later in 2011, the PCAOB issued a proposal for public comment. The 2011 proposal would have required public auditors to disclose the name of the engagement partner in each audit report, but would not have required the partner to sign the report. It also would have required each audit report listed in a public accounting firm's Annual Report Form to identify the relevant engagement partner and would have required each audit report to disclose the name of any independent public accounting firm or other person who took part in the audit.

After receiving still more public comments and waiting another two years, the PCAOB issued the revised proposal currently under consideration. The 2013 proposal would still require the disclosure of engagement partner names on audit reports, but would no longer require the partner names to be listed on the Annual Report Forms. It would still require audit reports to disclose the name of any third party public accounting firm that participated in the audit, but would no longer require disclosure of the names of other persons who took part in the audit. Overall, the 2013 proposal is disappointing, given the many years involved in its production and its continued weakening of the transparency measures proposed in 2009 and 2011. While it still proposes important transparency and accountability features, the 2013 proposal falls short of what is needed and should be strengthened by reinstating key transparency measures in the earlier PCAOB releases.

Increased Public Disclosure. The PCAOB effort to increase public disclosures about who actually conducts and is responsible for particular audit reports is a welcome departure from a long history of excessive secrecy and weak accountability for U.S. public company audits.

Most public company audits are now performed by a small number of large firms. The "Big Four" accounting firms, which reported record revenues of over $100 billion in 2013 alone,[14] employ thousands of auditors with differing experience, qualifications, expertise, and work performance. Currently, these firms provide no routine public information about the

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[13] See paragraph 3 of Auditing Standard No. 9, "Audit Planning"; see also paragraph 3 of Auditing Standard No. 10, "Supervision of the Audit Engagement."

[14] See, e.g., "PwC FY 2013 Global Revenues Grow to US $32.1 billion" (Oct. 3, 2013), http://press.pwc.com/GLOBAL/News-releases/pwc-fy-2013-global-revenues-grow-to-us32.1-billion/s/a25dfdaa-5ae8-4818-b09a-99a3821e3765; "Deloitte grows for fourth consecutive year, reporting US $32.4 billion in revenue" (last updated Sept. 16, 2013), http://www.deloitte.com/2013revenues; "EY reports 2013 global revenues of US$25.8 billion" (Oct. 8, 2013), http://www.ey.com/GL/en/Newsroom/News-releases/News_EY-reports-2013-global-revenues-of-US-25-8-billion-dollars#.Utli7BAo5aQ; "KPMG achieves record global revenues for FY13" (Dec. 12, 2013)(reporting "record-high aggregated revenues of US$23.42 billion"), http://www.kpmg.com/global/en/issuesandinsights/articlespublications/press-releases/pages/kpmg-achieves-fy13-global-revenues.aspx .

engagement partner who is responsible for the audit of a particular company nor do they provide information about any third party contributor to their audits. Investors, lenders, regulators, and others currently have no means for tracking audit partners responsible for accurate audits or audit failures.

Because auditing firms are paid by the companies whose financial statements they audit, inherent conflicts of interest make public accountability and transparency all the more important. An accounting firm that receives large auditing fees from a client becomes susceptible to pressures by that client to overlook problems or resolve auditing issues in ways that are overly favorable to the client, or risk losing fee revenue. Engagement partners that recommend advising a client to accept a disagreeable auditing result may receive little or no support from colleagues concerned about losing business. Auditing firms attempting to sell consulting services to audit clients may also seek to pressure colleagues to avoid making negative audit findings. Public accountability, in which specific audit partners are recognized for high quality audits, as well as audit failures, can be a powerful antidote to such internal pressures.

Disclosing the Engagement Partner. Multiple reasons support disclosing the name of the engagement partner responsible for a particular audit. First is the impact on audit quality. Publicly tying the lead auditor's professional reputation to the audits for which that partner is responsible would encourage the partner to require better audit procedures, exercise better supervision of the audit team, and perform a more careful review of the audit results. It may also deter poor oversight, sloppy procedures, and high risk audit practices leading to unreliable audit opinions. Audit quality would improve, not only because engagement partners would want to protect their professional reputations, but also because public disclosure would expand the audience to which each partner would be routinely answerable, from the partner's firm and the audit client, to the broader business community, including investors, lenders, regulators, policymakers, and fellow auditing professionals.

Second, disclosure of the engagement partner's name would strengthen audit transparency by shedding light on the audit process and facilitating communications. Identifying the engagement partner would alert the audited corporation's officers, directors, audit committee, and employees to the key person responsible for resolving audit issues and help corporate employees communicate any auditing concerns to the right person. It would also inform persons outside of a public company, including investors, lenders, regulators, and others, of the right person to contact with financial reporting interests or concerns. In addition, knowing the key person responsible for an audit could facilitate investigations, simplify research, and aid in evaluating audit reports. Investigations examining financial misconduct would also be more efficient and effective if they had ready access to the names of the engagement partners responsible for particular audit reports.

Public disclosure would also facilitate evaluation of senior auditors and the audit reports for which they are responsible. Disclosure would enable not only the audit client, but also investors, lenders, regulators, and other financial statement users, to identify and evaluate an engagement partner's experience, expertise, track record, and work for other clients that might present conflict of interest problems. It would also help shareholders evaluate audit firm performance when asked to vote on keeping or changing the company's public auditor.

Third, disclosure of the engagement partner would strengthen both partner and firm accountability for audit failures. Right now, when a company is found to have engaged in misleading or fraudulent accounting, the identity of the engagement partner is not readily apparent; making that information publicly available would facilitate holding particular engagement partners accountable for the audits they oversee. Because both the engagement partner and the public accounting firm would be identified in the audit report, the current proposal intentionally and clearly signals that accountability is intended to attach to both. In addition, as engagement partners are often indemnified by their employers in the same manner as officers and directors of corporations, any lawsuit over inaccurate financial reporting would likely affect the firm as well as the partner, providing an added incentive for the firm to monitor the performance of its engagement partners.

A fourth reason to support the PCAOB proposal is that it would promote auditor independence by highlighting the occasions on which an engagement partner is replaced. The Permanent Subcommittee on Investigations conducted an examination into the collapse of Enron Corporation in 2002, and discovered that when an Arthur Anderson senior partner raised objections to certain Enron accounting practices, he was removed at Enron's request, with no public notice.[15] The Enron investigation demonstrates that even senior auditors can be removed at the request of a client displeased with their accounting advice. Disclosure of an engagement partner's name and any replacement might discourage audit clients from inappropriately pressuring that partner or the audit firm to cooperate with its accounting requests, since any replacement would require public notice and, in turn, raise public questions about the reasons for the replacement.

To further support auditor independence, the proposal could be strengthened by requiring registered public accounting firms to file a special report on Form 3 within a few days of replacing an engagement partner in charge of a public company audit.

Still another reason to support disclosure of the engagement partner is that it would bring U.S. audit professionals in line with other U.S. corporate professionals and their international counterparts. The Federal Reserve already requires bank holding companies to provide the names of their audit engagement partners.[16] The European Union already requires its member states to compel audit reports to be "signed by at least the statutory auditor(s) carrying out the statutory audit on behalf of the audit firm."[17] In addition, U.S. corporate officers already sign their names to a variety of opinions and reports filed with the SEC, including certifications regarding the accuracy of the corporation's financial statements, while a majority of corporate directors sign their corporation's Annual Form 10-K. Attorneys are required to sign a variety of documents filed with federal and state regulators and the courts. The PCAOB would bring U.S. audit professionals into closer alignment with other public company professionals by requiring public audit reports to identify the audit engagement partners responsible for the audit opinions presented to, and intended to be relied upon by, the investing public.

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[15] See, e.g., "The Role of the Board of Directors in Enron's Collapse," S. Hrg. 107-511 (May 7, 2002), at 5, 582-88.

[16] See Form FR Y-9C, "Consolidated Financial Statements for Bank Holding Companies," at 11.

[17] "Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on Statutory Audits of Annual Accounts and Consolidated Accounts," L157 OFFICIAL JOURNAL OF THE EUROPEAN UNION 87, 96, 98 (Sept. 6, 2006), http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:157:0087:0087:EN:PDF.

Requiring A Signature. The PCAOB 2011 proposal sought comment on whether, in addition to disclosing the name, an engagement partner should be required to sign the audit report for which the partner is responsible. Other countries such as the United Kingdom, Australia, and Taiwan already require signed audit reports.[18] In the 2013 proposal, the PCAOB described the comments it received in response to the 2011 proposal and determined that it would not require engagement partner signatures, primarily due to concerns about whether providing a signature would increase an audit partner's potential legal liability. Instead, the 2013 proposal concluded that providing the engagement partner's name and not signature would provide most of the same potential benefits while avoiding personal liability concerns.[19]

Since the goal of the PCAOB's work is to improve audit quality, rather than shield individual auditors from legal liability, it is troubling that the Board has focused so much of its analysis on liability concerns and has based its decision on whether to require signatures in large part on that issue. Its decision is also troubling since the 2013 proposal seems to acknowledge that requiring auditor signatures would create stronger incentives for audit quality.[20]

As one Board member has already pointed out:

> "The principle of accountability extends to most professionals in the United States who are clearly identified under federal or state law. For example, tax accountants sign tax returns, and engineers and architects sign their engineering and architectural designs. It is hard to understand why auditors should be held to a different standard."[21]

In addition, professions such as public accounting have long nurtured trust and respect by placing the reputation of their senior professionals on the line in support of their work. An audit report that carries the personal signature of a financial professional would not only strengthen audit quality, transparency, and accountability, but also help restore the personal responsibility critical to a trustworthy and respected accounting profession.

Disclosing Third Party Audit Participants. In addition to disclosing engagement partner names, the PCAOB proposal contains an important provision that would require audit reports to disclose information about certain third party participants that performed some of the audit work. This provision would shine needed light on a little known and difficult to monitor area of auditing, while significantly strengthening audit quality, transparency, and accountability.

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[18] See PCAOB Release No. 2013-009, at 3-4.

[19] See id., at 7-8 ("In the Board's view, this disclosure approach retains most of the potential benefits of a signature requirement, while mitigating some of the concerns, particularly liability concerns, expressed by commenters on the 2009 Release.").

[20] See, e.g., id. at 6 (The PCAOB Release states: "The ACAP report stated that '[t]he Committee believes that the engagement partner's signature on the auditor's report would increase transparency and accountability,'" referring to the U.S. Department of the Treasury's Advisory Committee on the Auditing Profession, *Final Report of the Advisory Committee on the Auditing Profession to the U.S. Department of the Treasury*, VII:20 (Oct. 6, 2008), available at http://www.treasury.gov/about/organizationalstructure/offices/Documents/final-report.pdf.).

[21] Steven B. Harris, PCAOB Board Member, *Statement on the Reproposal on Improving Transparency Through Disclosure of Engagement Partner and Certain Other Participants in Audits* (Dec. 4, 2013) .

When investors see the name of a major auditing firm on an audit report, they may make certain assumptions about the quality of that audit based upon that company's reputation. It is often the case, however, that an accounting firm issuing an audit report has not performed 100% of the underlying audit work, but has instead delegated all or a portion of the work to one or more outside parties, including independent accounting firms, consultants, or specialists in particular areas. Financial statement users, who must determine whether to rely on an audit opinion, should have detailed information about the extent to which some or all of the work in a particular audit was outsourced to outside parties, the identity of those third parties, and whether the outside party is subject to PCAOB oversight.

The Permanent Subcommittee on Investigations has firsthand experience with the variability of audit work performed by different firms. For example, a year-long investigation conducted by the Subcommittee into illicit money flows involving banks in foreign jurisdictions uncovered a host of problems with foreign auditors, especially those operating in foreign jurisdictions with strong secrecy laws and weak anti-money laundering controls.[22] A number of foreign accountants contacted during the investigation were uncooperative or even hostile when asked for information. A PricewaterhouseCoopers auditor in Antigua serving as a government-appointed liquidator for Caribbean American Bank (CAB), for example, refused to provide copies of its report on CAB's liquidation proceedings, even though the reports were filed in court, they were supposed to be publicly available, and the Antiguan government had asked the auditor to provide the information to the investigation. The investigation also came across evidence of conflicts of interest and incompetent or dishonest accounting practices. In one instance, an accounting firm located in Dominica verified a $300 million item in a balance sheet for British Trade and Commerce Bank that, when challenged by Dominican government officials, was never substantiated. In another instance, an accounting firm approved an offshore bank's financial statements which concealed indications of insolvency, insider dealing, and questionable transactions. While the above examples involved foreign auditors reviewing the records of local banks and not U.S. publicly traded corporations, their record of poor performance and poor cooperation with U.S. inquiries provides clear evidence of the need for disclosure.

The auditing failures cited earlier provide additional evidence. Accounting scandals involving Laptop Financial Technologies, Ltd., Olympus Corp., Satyam Computer Services Ltd., and the unnamed companies audited by the Chinese firms sanctioned for refusing to cooperate with U.S. document requests all involve foreign auditors that share a common brand with large accounting firms in the United States, but may not use the same auditing standards, have the same familiarity with U.S. accounting requirements, or employ auditors with appropriate expertise. It is also not uncommon for a Big Four accounting firm to refuse to accept financial liability for faulty audit work performed by a foreign affiliate, even when sharing a common brand. Audit clients, investors, lenders, regulators, and others ought to be able to determine the extent to which affiliated or unaffiliated third parties are performing audit work, their identities, and the extent to which the public accounting firm shares financial liability for any problems arising from the third party audit work.

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[22] See "Role of U.S. Correspondent Banking in International Money Laundering," S. Hrg. 107-84 (Mar. 1, 2, 6, 2001). This investigation took place prior to the establishment of the PCAOB.

Another key issue is the extent to which a third party performing audit work falls under PCAOB jurisdiction, cooperates with PCAOB and SEC information requests, and undergoes PCAOB inspections to ensure audit quality. Auditors outside the United States may not have agreed to undergo PCAOB oversight, even if they audit a company that trades on a U.S. stock exchange or holds a U.S. license as a broker-dealer. Alternatively, the firm may have agreed to PCAOB oversight, but their governments may not permit PCAOB inspections or exchanges of information. In an ongoing investigation into alleged accounting fraud affecting U.S. investors in Longtop Financial Technologies, for example, China took years to agree to allow the Shanghai affiliate of Deloitte & Touche to provide documents to the PCAOB or SEC,[23] and has yet to allow similar document productions related to numerous other companies suspected of accounting fraud.[24] A 2007 PCAOB report also criticized Deloitte's quality controls and the manner in which it worked with foreign affiliates operating under a common brand, noting that Deloitte partners often had no way to properly assess whether a foreign affiliate's personnel were adequately familiar with American accounting and auditing rules.[25]

Audit clients, investors, lenders, regulators, and others should be able easily to determine whether audit work is being performed by auditors that operate outside of PCAOB oversight, are likely less familiar with U.S. accounting and auditing rules, have poor track records, or have a history of disciplinary problems or other misconduct.

The 2013 proposal addresses these concerns by requiring public company accounting firms to identify in each audit report the portion of the audit work that was performed by third parties, the estimated percentage – within ranges – of the audit hours each such third party performed, and the country where each such party was headquartered or performed the work. In addition, in one of the few instances in which the 2011 proposal was strengthened, the 2013 proposal would cover, rather than exempt from disclosure as in 2011, those audit participants "engaged by the auditor with specialized skill or knowledge in a particular field other than accounting or auditing."[26] This broader coverage, which would encompass consultants and financial analysts, is important, not only because such persons frequently perform important work in public company audits, but also because this approach eliminates an exemption that might have encouraged public company accounting firms to use non-accountants as a way to avoid the audit disclosure requirements.

The 2013 proposal would also require some, though not all, of the audit participants to be identified by name. In the case of independent public accounting firms that performed 5% or more of the audit work, the 2013 proposal would require each such firm to be named in the audit report. The 2013 proposal would apply that requirement to both affiliated and unaffiliated public

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[23] See, e.g., SEC v. Deloitte Touche Tohmatsu CPA Ltd., Case No. 1:11-MC-00512 (D.D.C. filed Sept. 8, 2011); In re Longtop Financial Technologies Ltd., Case No. 3-14622 (Nov. 10, 2011), http://www.sec.gov/litigation/admin/2011/34-65734.pdf; "Deloitte's Quandary: Defy the S.E.C. or China," New York Times (Oct. 20, 2011), http://dealbook.nytimes.com/2011/10/20/deloittes-quandary-defy-the-s-e-c-or-china/; "China to Hand Over Audit Documents," Wall Street Journal (July 11, 2013), http://online.wsj.com/news/articles/SB10001424127887324425204578600582169764600.

[24] See footnote 10, supra.

[25] "Report on 2007 Inspection of Deloitte & Touche LLP," PCAOB Release No.104-2008-070A, at 1, 3, 17 (May 19, 2008), http://pcaobus.org/Inspections/Reports/Documents/2008_Deloitte.pdf.

[26] See PCAOB Release 2013-009, at 15-16.

accounting firms, so long as the third party firm operated on an independent basis from the firm filing the audit report. Recent examples involving Chinese auditing firms that were affiliated with major U.S. accounting firms and approved financial statements for U.S. publicly traded corporations later accused of accounting fraud demonstrate the need for investors to know the names of both affiliated and unaffiliated public accounting firms when judging the value of an audit opinion. Investigatory bodies, such as the Permanent Subcommittee on Investigations, would also be assisted by public disclosure of the names of both affiliated and unaffiliated public accounting firms that worked on public company audits later found to be defective.

Emerging Growth Companies. The 2013 proposal requests comment on whether its disclosure requirements should apply to audit reports for emerging growth companies as defined in the Jumpstart Our Business Startups Act ("JOBS Act") of 2012. They should.

Emerging growth companies are relatively new publicly traded corporations with less than $1 billion in total annual gross revenues. Since those companies typically have limited track records, are excused from complying with a number of accounting rules that apply to other publicly traded corporations, are permitted to provide only two instead of three years of financial data, and often express doubt about their ability to continue as going concerns,[27] it is particularly essential that investors be able to evaluate the reliability of the audit opinions for their financial statements.

Excusing emerging growth company auditors from disclosing the engagement partners and third parties that conducted the audit work would weaken the incentives to conduct high quality audits of those companies, while also impeding the ability of investors and other financial statement users to evaluate audit quality. If the proposed disclosures named reputable audit participants, they could boost confidence in emerging growth companies' financial statements which otherwise might be viewed with suspicion. For those reasons, applying the disclosure requirements to emerging growth companies would meet the statutory standard of being "necessary or appropriate in the public interest," providing "protection to investors," and promoting "efficiency, competition, and capital formation."[28]

B. 2011 Transparency Measures That Should be Reinstated

While the current proposal merits support for improving audit quality, transparency, and accountability, it also merits criticism for removing or weakening important transparency measures in the 2011 proposal. Those provisions, which would require annual reports filed with the PCAOB to disclose audit engagement partner names and require audit reports to name all third party audit participants that performed substantial work, should be restored in the final rule.

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[27] The PCAOB determined that, as of October 2013, 55% of emerging growth companies registered with the SEC had an explanatory paragraph in the auditor's report on their most recent audited financial statements stating there was substantial doubt about the company's ability to continue as a going concern. PCAOB Release 2013-009, at 38.

[28] See Section 103(a)(3)(C) of the Sarbanes-Oxley Act, (15 U.S.C. §7213(a)(3)), as added by Section 104 of the JOBS Act, Pub. L. No. 112-106 (To apply a new accounting requirement to emerging growth companies, the SEC must determine that applying the requirement "is necessary or appropriate in the public interest, after considering the protection of investors, and whether the action will promote efficiency, competition, and capital formation.").

Disclosing Engagement Partner Names in Annual Reports. Public accounting firms currently file with the PCAOB an Annual Report Form listing each of the audit reports they issued during the covered year.[29] Unlike the 2011 proposal, the 2013 proposal no longer provides that it would amend the Annual Report Form to require public accounting firms to identify the engagement partner responsible for each of the listed audits. This disclosure requirement, which offers an inexpensive, sensible, and effective means for strengthening audit quality, transparency, and accountability, should be restored in the final rule.

Naming engagement partners in the Annual Report Form would increase transparency by providing a logical and convenient mechanism for financial statement users to retrieve information about the work assigned by a public accounting firm to its engagement partners over the course of a year. The information for each firm would appear in a single, easily accessible document, since the annual reports are posted by the PCAOB on its website. The report disclosures would enable audit clients, investors, lenders, regulators, and others to research and understand the work performed by a particular engagement partner, including by identifying the clients served by the partner, depicting the partner's overall workload, and making it easier to identify any conflict of interest or disciplinary issues. It would also facilitate oversight of audit firms as a whole by making available in one location all of the work assignments made to individual engagement partners during the year. Dropping the annual report requirement would not prevent financial statement users from compiling this same information on their own, but it would require them to engage in time consuming, costly, and duplicative efforts to reconstruct information that could otherwise easily be provided by accounting firms in their annual reports.

Naming engagement partners in the Annual Report Form would also strengthen audit quality and accountability by enabling more efficient and effective analysis of the audit work performed by individual partners and the audit firm as a whole. These disclosures would encourage engagement partners to provide consistent, high quality work, because knowing that the public can obtain the partner's name on an audit-by-audit basis is not the same as knowing that the public can more readily review every audit performed by that partner during the year. In addition, the disclosures would help ensure that public accounting firms assign audits to engagement partners with appropriate expertise and availability, and avoid conflicts of interest that might otherwise be hidden from public view. The disclosures would also promote auditor independence by highlighting any engagement partner replacements during the covered year.

Given the ease and low cost associated with listing engagement partner names in firms' annual reports, it is difficult to understand why the 2013 proposal dropped this disclosure requirement. The 2013 does not give any reason or explanation for doing so, does not cite a single 2011 comment letter opposing the annual report disclosure requirement, and does not describe any potential negative features or consequences from the proposed disclosures.[30] This transparency measure should be restored in the final rule.

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[29] See PCAOB Rule 2201; PCAOB Form 2 - Annual Report Form, http://pcaobus.org/Rules/PCAOBRules/Pages/Form_2.aspx; "Staff Questions and Answers Annual Reporting on Form 2," PCAOB, at 1, 2 (June 17, 2011), http://pcaobus.org/Registration/rasr/Documents/Staff_QA-Annual_Reporting.pdf (stating "[e]ach registered firm must provide basic information once a year by filing an annual report on Form 2."). The report must be filed by June 30 of each year.

[30] See PCAOB Release 2013-009, at 33-34.

Disclosing Third Party Audit Participant Names. The 2013 proposal also weakens third party audit participant disclosures compared to the 2011 proposal, allowing for a larger portion of third party audit participants to remain unidentified, creating incentives to use non-accounting firms to perform audit work to avoid disclosure obligations, and reducing overall transparency. Those weakening changes should be reversed.

While the 2013 proposal reduces transparency in several ways,[31] one ill-advised change from the 2011 proposal is its decision to no longer require disclosure of the name of any third party audit participant other than an "independent public accounting firm," even if the unnamed party performed 5% or more of the audit work. For example, if the third party were a firm that was organized as a consultant or as a company that specializes in financial analysis, or if it were an individual who is not a certified public accountant, the 2013 proposal would allow that party's name to be concealed behind a general statement that the participants were "other firms" or "persons not employed by our firm." The result is that the 2013 proposal would allow, for example, the auditor filing an audit report to use a consulting firm that has a poor disciplinary record or is the subject of ongoing litigation without having to disclose the firm's identity, even if that consultant performed key audit procedures.

The 2013 proposal contains little justification or explanation for taking this narrow approach over the broader approach taken in the 2011 proposal, which called for identifying by name all third party audit participants that exceeded the reporting threshold. The 2013 proposal simply asserts that the "names of other types of companies or individuals not employed by the auditor may not be as meaningful as the fact of their participation and the location where the work was performed."[32] That analysis fails to recognize that disclosing the names of those audit participants would make it possible to learn whether any were suspected of wrongdoing, had been sued or disciplined for substandard work, or were operating with inappropriate conflicts of interest. If, on the other hand, the audit report named reputable firms or experts, the disclosures could reassure financial statement users about the quality of the audit. Omitting the names would hinder all such evaluations. The proposal's analysis also fails to recognize that making the names public would provide the same type of encouragement for the named parties to engage in high quality work as it would for public accounting firms.

The 2013 proposal does not estimate how many audit participant names would be omitted under its more narrow approach, or explain why non-accounting firms in particular should be exempted from identification. The increased complexity of the rule might also lead to audit firms making inconsistent decisions about which third party participant names to disclose. The likely result is that audit clients, investors, and other financial statement users would be left in the dark about the identity of many third party audit participants, including those that performed more than 5% of the audit work. Since the filing auditor already knows the names of all of its

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[31] For example, the 2013 proposal raises the threshold for disclosing third party audit participants from 3% to 5%, stating that any third party firm or individual that contributed less than 5% of the audit work may be aggregated and listed simply as "other firms" or "other persons not employed by our firm." PCAOB Release 2013-009, at 17. It also permits accounting firms to estimate the percentage of audit work performed by a third party audit participant using specified ranges rather than provide a specific percentage. Id.

[32] PCAOB Release 2013-009, at A3-11.

audit participants, the 2013 proposal does not and cannot explain how omitting the names of those that exceeded the reporting threshold would save time, money, or effort.

Limiting the disclosure of third party names to public accounting firms would not only open a huge disclosure loophole and remove an incentive for the unnamed parties to conduct high quality work, but may also create an incentive for public accounting firms to employ non-accountants whose names can be concealed. This unintended consequence of the 2013 proposal could result in public accounting firms losing business to other types of firms, such as consultants and financial analysts, that have less accounting expertise, will be subject to less public scrutiny, and will operate outside of PCAOB oversight and disciplinary authority. This outcome could be avoided by reviving the 2011 requirement that all third parties exceeding the reporting threshold be named in the audit report.

The stronger disclosure provisions for third party audit participants in the 2011 proposal should be reinstated to the final rule to shine needed light on a critical area with direct impact on audit quality, transparency, and accountability. All third party audit participants performing 5% or more of the audit work should be identified in the audit report by name, country, and an estimated percent of the audit hours they performed. This information is already known to the public company auditor, would cost little to report, and would provide important information to financial statement users reliant on public company audits, including audit clients, investors, lenders, regulators, and investigatory bodies like the Permanent Subcommittee on Investigations.

In fact, rather than weaken the 2011 proposal, the final rule should strengthen its transparency requirements by requiring the public accounting firm issuing the audit report to disclose the nature of the work performed by each third party audit participant performing 5% or more of the audit, and whether each such third party was subject to PCAOB oversight and inspection. Given the variance in auditor expertise, resources, and reputation, knowing what aspects of an audit were performed by a particular third party and whether that party fell within the ambit of the PCAOB may be critical to assessing audit quality.

Thank you for the opportunity to comment on this matter.

Sincerely,

Tom Coburn, M.D.
Ranking Minority Member
Committee on Homeland Security
and Governmental Affairs

Carl Levin
Chairman
Permanent Subcommittee on Investigations