



Office of the Secretary  
Public Company Accounting Oversight Board  
1666 K Street, NW  
Washington, DC 20006-2803

February 4, 2014

**RE: PCAOB Rulemaking Docket Matter No. 029, *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***

Dear Madame Secretary:

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's ("PCAOB" or "Board") proposals, *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* ("Proposing Release"). These proposals would amend the Board's auditing standards to require the audit report to include (1) the name of the engagement partner on the most recent audit and (2) information about independent public accounting firms, other than the principal auditor, and certain other persons that participate in the audit ("Audit Participants"). The proposals modify the Board's prior proposals issued in 2011.<sup>1</sup>

## **INTRODUCTION AND RECOMMENDATIONS**

In our comments on the 2011 proposal, we supported the objective of promoting transparency and providing users of financial statements with appropriate information to enable them to assess the qualifications and capabilities of the registered public accounting firm that attests to an issuer's financial statements. However, we expressed concerns that the Board's proposals may not provide meaningful information to users of audit reports or enhance audit quality. We also expressed concerns about the potential litigation impact on the persons proposed to be identified in the audit report.

We believed then, and still believe, that the most relevant and useful information for users in assessing the quality and reliability of an audit is the identity of the firm itself, not the name of the individual engagement partner who is unlikely to be known to the public. To the extent users need information about the firm and its audits, they have available to them the firm's public filings with the PCAOB and the PCAOB's inspection reports. Many firms also make public their own quality control reports pursuant to NYSE rules, and some firms, including ours, issue audit quality reports that provide information beyond what is required by the NYSE. The Board's project related to audit quality indicators also has the intent of providing useful information about the firms.

Nonetheless, in our comments on the Board's 2011 proposal, we recognized that many users ascribe value to information regarding the identity of the engagement partner. We expressed our support for one aspect of the Board's proposals—that the engagement partner be identified in the firm's annual report on Form 2—if it was coupled with identification of a member or members of firm leadership in Form 2. We

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<sup>1</sup> *Improving the Transparency of Audits: Proposed Amendments to PCAOB Auditing Standards and Form 2*, PCAOB Release No. 2011-007 (Oct. 11, 2011) ("2011 Release").



believed that including information about firm leadership would alleviate any misimpressions that the audit is the product of the engagement partner, rather than the firm.<sup>2</sup>

The Board did not incorporate our recommendations about engagement partner and firm leadership identification into its revised proposed standards. Unlike the prior proposal, the Proposing Release does not provide for any Form 2 reporting. In response to our and others' comments, the Board has modified its proposal regarding Audit Participants in certain respects, including by increasing the threshold for identification from three percent of total hours incurred in the audit to five percent, limiting the Audit Participants who are identified by name to other accounting firms, and permitting reporting in percentage ranges instead of a specific number.

We renew our prior support for transparency, through means other than identification in the audit report itself, about the name of the audit engagement partner, when coupled with the name of a member or members of firm leadership. We also support providing the prescribed information about Audit Participants through means other than inclusion in the audit report. We continue to believe that the perceived benefits of including information about the engagement partner and other Audit Participants in the audit report itself are substantially outweighed by the significant potential litigation risks and costs that this creates and the practical difficulties created by the requirement to obtain consents.

For these reasons, which we discuss further below, we urge the Board pursue a reporting mechanism other than the audit report, as we believe there are alternative mechanisms to advance the Board's objectives while mitigating the negative consequences of including information in the audit report. The alternatives include the following, but there may be other workable approaches:

- Establishing a new PCAOB reporting mechanism—either in existing Form 2 or a new reporting format—that would require firms, on a reasonably current basis, to identify the engagement partner and member or members of firm leadership, and to provide the prescribed information about Audit Participants.
- Pursuing alternatives that would make the aforementioned information available in a company's proxy statement or other public filings with the SEC, in such a manner that it would not be incorporated by reference into any Securities Act registration statements.

Regardless of the location of the information, we believe it is important to assist users in putting the new information in appropriate context and not drawing unwarranted conclusions about the engagement partner or the audits he or she oversees. For example, we think users need to understand matters such as:

- An audit is the responsibility of the firm that issues the audit report, not just the individual identified as the engagement partner.

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<sup>2</sup> We also suggested that, if the Board did pursue the identification of the engagement partner in the audit report, it make it subject to other conditions that, in our view, would mitigate our concerns regarding litigation risk. Our proposals included adopting the proposal for a provisional period of five years to allow the Board to monitor the development of the law and deferring effectiveness of the proposal until the SEC took action to assure that engagement partners would not be considered "experts" for purposes of liability under section 11 of the Securities Act. See Letter from PricewaterhouseCoopers LLP, PCAOB Rulemaking Docket No. 029 (Jan. 9, 2012) ("PwC 2012 Letter").



- An engagement partner should not be associated with a company’s issues, such as a business failure due to the company’s business model or performance, or other factors affecting stock prices or valuations.
- The fact that a company may have a restatement should not be reflexively attributed to an individual engagement partner, because a restatement can be the result of many factors outside of the auditor’s control.
- Users should not draw conclusions about the expertise and experience of an engagement partner based only on the public company engagements that he or she may be identified with pursuant to the Board’s auditing standards; a partner may have significant other experience that has prepared him or her to be the “lead” engagement partner, and qualified partners should not be denied opportunities to serve as an engagement partner because they do not meet criteria developed based on the public record.
- Similarly, in considering the qualifications of an individual to serve as engagement partner, users should also understand that others within the firm significantly contribute to the audit.
- As to Audit Participants for which information is provided, the principal auditor is responsible for the entire audit and expresses an opinion about the financial statements taken as a whole; the principal auditor must take steps to satisfy itself that it can rely on the work of the Audit Participants in rendering its audit report (except in those cases where the principal auditor expressly does not take the responsibility for the audit of a component of a company that is audited by another firm).

The Board can help convey this proper context by a variety of means, including through its rulemaking releases, appropriate notices on the reporting sites and educational outreach to users and other constituencies.

## **DISCUSSION**

We support transparency about the engagement partner and Audit Participants *as long as* the benefits of providing that information are not outweighed by other considerations. The Proposing Release rests principally on a disclosure rationale—information about the engagement partner and Audit Participants will be useful to users of financial statements. The Board has appropriately de-emphasized the rationale set forth in its 2011 proposals that identification of the engagement partner would enhance engagement partner “accountability,” which the Board posited would lead to improved engagement partner performance and improved audit quality. Based on the disclosure rationale, we accept that users will in fact ascribe value to this information, but we believe that the benefits can be achieved through alternative means for conveying the same information in accessible formats. Including the names of the engagement partner and Audit Participants in the audit report itself—as opposed to alternative reporting methods—creates risks of liability and practical challenges that substantially outweigh the benefits of including the information in the audit report.



We first discuss alternatives that could provide the benefits sought by the Board. We then address the litigation risks and practical challenges that we believe outweigh the benefits of including the information about the engagement partner and Audit Participants in the audit report.

### ***Alternative Means to Provide Transparency***

We believe that alternatives are available that would make information about engagement partners and Audit Participants as accessible to users as inclusion in the audit report. Indeed, using an alternative mechanism might in fact facilitate the ability of interested parties to obtain information about engagement partners and Audit Participants. Alternative transparency mechanisms could include:

- *PCAOB Reporting Mechanism.* The Board could establish a requirement that identification of the engagement partner and information about the Audit Participants be reported in a filing with the Board. This mechanism could be incorporated into current Form 2 or a new form. The firm would identify the engagement partner and a member or members of firm leadership in a format other than the audit report itself in the filing. This form of transparency would be responsive to the requests of users but also make clear that the engagement partner alone is not responsible for the issuance of the report. Similarly, information about Audit Participants could be included in the PCAOB filing. The reporting could be required on a periodic basis so that the information would be reasonably current after issuance of the relevant audit report. For example, a quarterly report could be required for all audit reports issued during the quarter or the information could be reported to the PCAOB within so many days after the issuance of the audit report, if there is a need for it be timelier. This would address the concerns expressed by the Board that providing the information on the firm's Form 2 annual report would not be easily accessible to users and would not be timely. Besides providing information comparable to the information that the Proposing Release would include in the audit report, this report would provide a single source for searchable information about a firm's engagement partners, which would be more convenient for users than having to derive the information from multiple, separate SEC reports. We do not believe that the costs of complying with this requirement would be significant for accounting firms.
- *Enhanced SEC Disclosure.* The Board could pursue alternatives that would make the aforementioned information available in a company's proxy statement or other public filings with the SEC. The Board could recommend to the SEC that it consider rulemaking in this area to provide for inclusion of this information in a part of the proxy statement (such as the audit committee report) that would not be incorporated by reference into any Securities Act registration statements. If this information is not incorporated by reference, then no consent under sections 7 or 11 would be required. Assuming, as the Board suggests, that engagement partner and Audit Participant information would be relevant to a stockholder's decision whether to ratify auditor appointments or otherwise useful to users, we believe this approach is preferable to the Board's unilaterally adopting new disclosure requirements which are more appropriately the province of the SEC. In addition, the information contained in the proxy would be equally as accessible to users as information contained in the audit report. Placing this disclosure in the proxy statement or other filing could give companies the flexibility to provide more context about the roles of the engagement partner and Audit Participants as it relates to auditor oversight.



We also renew our recommendation that any reporting regarding named Audit Participants should also include explanatory language to the effect that the named Audit Participants are separate legal entities and, if they are members of the same network as the principal auditor, that the network firms follow a common audit methodology and consistent quality controls.

***Potential Liability For Engagement Partners and Audit Participants Named In The Audit Report***

Engagement partners and Audit Participants have a legitimate concern that being named in the audit report could expose them to incremental private civil litigation and personal liability. We do not believe the Board has adequately considered these risks in advancing its proposed standards.

*Securities Act Section 11*

In prior consideration of this subject, the Board consistently emphasized that its intent was not to increase the liability of engagement partners.<sup>3</sup> In the Proposing Release, however, the Board assumes that naming the engagement partner and Audit Participants in the audit report will impose statutory liability on them under section 11 of the Securities Act, liability that they do not currently possess.<sup>4</sup> A claim under section 11 can be particularly potent, because purchasers of securities under a registration statement can recover from named experts for material misstatements or omissions in their reports, without the same requirement to prove scienter and causation that apply to other claims under the securities laws. While section 11 provides experts with a “reasonable investigation” defense, it places the burden of proof on the defendants.<sup>5</sup> We believe the Board unduly minimizes the uncertainties and costs of such liability. Private securities litigation is inherently complex, and the Board should be wary of basing its determinations on untested generalizations about the potential impact of imposing new potential securities liability.

The Board offers various rationales why the liability risk is not significant. The Board suggests that an engagement partner’s liability under section 11 would be “coextensive” with that of the firm. Even if that is the case, it is difficult to predict how litigation naming both an accounting firm and the engagement partner will play out in practice, as there are no precedents for such a situation. It is at least conceivable, for example, that the firm’s and the engagement partner’s legal or factual positions may differ as to the “reasonable investigation” defense under section 11(b)(3) of the Securities Act. Similarly, the Board’s apparent assumption that the engagement partner will not face personal financial exposure for a section 11 claim is questionable. As the Board itself notes, there are serious questions as to whether one party can indemnify another for securities laws violations.<sup>6</sup> Moreover, there may be circumstances in which a firm cannot indemnify the individual (as in the case of insolvency) or may elect not to do so. Finally, the Board

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<sup>3</sup> 2011 Release, at 14; *Concept Release on Requiring the Engagement Partner to Sign the Audit Report*, PCAOB Release No. 2009-05, at 11 (July 28, 2009).

<sup>4</sup> The Board does not consider whether there are arguments that consents would not be required even if the engagement partner or Audit Participants are named in the audit report. In any event, there is no assurance that the SEC or issuers would accept those arguments and conclude that consents are not required.

<sup>5</sup> Section 11(b)(3)(B) provides that an expert who sustains the burden of proof shall not be liable with respect to his report if, at the time the registration statement became effective, “he had, after reasonable investigation, reasonable ground to believe, and did believe, . . . that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading.”

<sup>6</sup> Proposing Release, at 22n.50.



points to a study suggesting that section 11 cases against accounting firms are infrequent. Even if so, that provides little comfort to the individual who may become a defendant in such a case.

We also believe the Board understates the additional costs and other potential impacts that may result if it imposes section 11 liability on individual engagement partners. An individual named in the lawsuit may require separate counsel if his or her interests diverge from that of the firm and potential inter-defendant issues could complicate the defense of the litigation and drive up costs for all parties. Perhaps most importantly, we suggest the Board has not fully considered the significant personal and professional impact on an individual of being named as a defendant in a major litigation. No person wants to be named personally in a lawsuit. It could affect the individual's ability to obtain loans, impede the individual's ability to seek new employment, and have other reputational impacts in the individual's community. In addition, being named in a civil suit may also require notification to state accounting licensing authorities, which could trigger an investigation. All of these consequences can result even where there is no finding of liability.

As with naming engagement partners, the Board assumes that Audit Participants that are named in the audit report would be subject to liability under section 11. We believe the same considerations that weigh against imposing section 11 liability on engagement partners apply with equal, if not greater, force to named Audit Participants. Audit Participants that do not issue audit reports themselves do not currently face any material risk of section 11 liability, because the principal auditor takes responsibility for their work and the Audit Participants are not identified in a public document. If they become parties to section 11 litigation because they are named in an audit report, they will incur costs in defending this litigation, which can include counsel fees, discovery costs and management time and distraction. These costs could be substantial. And regardless of the liability risks, plaintiffs may opportunistically name Audit Participants as defendants in a section 11 case in order to gain advantage in the litigation or settlement.

#### *Securities Exchange Act Section 10(b) and Rule 10b-5*

The Board concedes in the Proposing Release that it "cannot conclude with certainty whether its approach might increase liability under Section 10(b)."<sup>7</sup> Yet it goes on to state that it believes "the better argument is that liability should not be increased under the *Janus* decision."<sup>8</sup> The Board's views, of course, are not binding on any court, and may provide little comfort to an engagement partner who will confront potential personal liability as a result of the new standards. In any event, we do not think the Board has adequately considered the current state of the law in this area.

We noted in the PwC 2012 Letter that uncertainty existed as to whether, in the wake of *Janus*, an individual can be deemed the maker of a statement that is issued by an entity. During the intervening two years this uncertainty has not been resolved. To the contrary, recent commentators have described the "ultimate authority" standard from *Janus* as a conundrum that "has played out with mixed results in cases involving allegations against corporate executives" and referred to cases subsequent to *Janus* as creating "a dichotomy of jurisprudence."<sup>9</sup> The Southern District of New York has also recognized that the issue of individual responsibility for corporate statements under *Janus* is "unsettled" in that district.<sup>10</sup>

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<sup>7</sup> Proposing Release, at 25.

<sup>8</sup> *Id.* (discussing *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011)).

<sup>9</sup> Max Stendahl, *Attorneys See Clouded Legacy for High Court's Janus Ruling*, LAW360, <http://www.law360.com/articles/447005/attys-see-clouded-legacy-for-high-court-s-janus-ruling> (June 4, 2013, 7:27)



Case law from as recently as October 2013 shows that courts remain willing to deem a corporate executive to be the “maker” of statements within a company’s disclosure document. In the civil litigation context, lower courts have continued to hold that individual corporate officers can be subject to Rule 10b-5 liability because they may have exercised “ultimate authority” over public statements issued by the company.<sup>11</sup> This trend has also continued in SEC enforcement actions.<sup>12</sup> A plaintiff could assert that the same principle should be applied to the engagement partner in an audit, and naming that person in the statement itself could be cited to support that allegation.

Given this continuing environment of uncertainty involving primary individual liability under Rule 10b-5, even after *Janus*, the possibility cannot be so easily dismissed that identifying the engagement partner in the audit report would be cited by plaintiffs, or potentially the SEC, as a basis for asserting that the engagement partner exercised “ultimate authority” over the report and therefore is liable for its contents. While we do not believe that these would ultimately be winning arguments, it may be some time before the issue is resolved in the courts.

It is also conceivable that plaintiffs may attempt to name accounting firms that participate in audits as parties in litigation based on a faulty audit report.<sup>13</sup> While we believe that the courts will ultimately reject Rule 10b-5 claims against Audit Participants, in the meantime, plaintiffs may nonetheless see a tactical advantage in naming them as defendants.

Naming the engagement partner or Audit Participants in the audit report also increases the potential that they could be individually named in state causes of action. While we believe that in the long run such claims are unlikely to prevail as a matter of law, it may be some time before that question is resolved in the courts.

### ***Practical Impact of Consent Requirement***

The new consent requirement for engagement partners and named Audit Participants could also create practical and logistical problems. Filing a consent may not be a one-time-only event. Even after the audit report is issued and the annual report on Form 10-K containing the report is filed, an issuer will require new consents from the named engagement partner and Audit Participants in order to include the report in subsequent, newly-filed registration statements and amendments. These consents will be required to be

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PM ET); Andrew Gillman, *Scope of Primary Liability Under Section 10(b) of the Exchange Act and SEC Rule 10b-5 Following Janus Capital Group*, 40 No. 3 SECURITIES REGULATION LAW JOURNAL 269, 283 (Fall 2012).

<sup>10</sup> See *City of Austin Police Retirement System v. Kinross Gold Corp.*, No. 12 Civ. 1203 (PAE), 2013 U.S. Dist. LEXIS 79892, at \*14 n.1 (S.D.N.Y. June 6, 2013).

<sup>11</sup> See *In re Pfizer Inc. Securities Litigation*, 936 F. Supp. 2d 252, 269 (S.D.N.Y. 2013); *In re Stillwater Capital Partners Inc. Litigation*, 853 F. Supp. 2d 441, 460 (S.D.N.Y. 2012).

<sup>12</sup> See *SEC v. Levin*, No. 12-21917-CIV, 2013 WL 5588224, at \*14 (S.D. Fla. Oct. 10, 2013) (“[A] person makes a statement for purposes of Rule 10b-5 when that person *has control* over the content, regardless of whether the person actually drafts the content.”) (emphasis in original); see also *SEC v. Dai Fotis*, 874 F.Supp.2d 870, 881 (N.D. Cal. 2012).

<sup>13</sup> See *Munoz v. China Expert Tech., Inc.*, No. 07 Civ. 10531, 2011 U.S. Dist. LEXIS 128539 at \*4 (S.D.N.Y. Nov. 4, 2011) (genuine issue of fact exists as to whether US affiliate of Hong Kong accounting firm “explicitly or implicitly controlled sufficiently—and thus ‘made’” the statements in the Hong Kong firm’s audit report, by virtue, among other things of US firm’s managing director giving final approval of the audit opinions prior to their being signed, and his being tasked with reviewing the entire filing for compliance).



dated concurrently with the relevant filings. This requirement will continue for at least a year, until the next audit report is issued.

The consent requirement would present problems with respect to partners who are no longer associated with the firm. It may be difficult, time-consuming or impossible to obtain consents from partners who are no longer associated with the firm, who are deceased, incapacitated or not easily reachable or who, being no longer associated with the firm, decline to provide a consent. If a consent is unable to be provided, the SEC may reject the filing as incomplete, or the issuer may have to request a waiver, which again could be time-consuming and result in additional expense.

In any case, providing consents will not be automatic. One question will be whether a former engagement partner who is asked to consent to use of his name will have to comply with the requirements of AU 711, *Filings Under Federal Securities Statutes* (“AU 711”). While the standard does not specifically address the responsibilities of named engagement partners, at a minimum the partner may need to follow them in order to ensure that he or she receives the benefit of the reasonable investigation defense of section 11(b)(3). That, in turn, will raise questions about how and under what conditions a former partner of the firm can be given access to confidential client information in order to perform the necessary procedures.

Even as to engagement partners who remain associated with the firm, there may be complications. Similarly to a partner who has left the firm, a partner who has rotated off the engagement, as required under the SEC independence rules, may need to follow the requirements of AU 711 in order to provide a consent and receive the benefit of the reasonable investigation defense of section 11(b)(3). We believe this will not have an impact on the firm’s independence or commencement of the partner’s time out period, but there is uncertainty as this is not addressed in either the SEC or PCAOB’s rules.

The Board rejects the proposition that Audit Participants that are named in the audit report may find it necessary to perform additional procedures or may charge more to compensate for accepting the additional risk of liability under US securities law. To the contrary, we believe that, at a minimum, the requirements of AU 711 may require the named Audit Participants to perform additional procedures when they are asked to consent to use of their work in a subsequent registration statement. More generally, we believe that foreign accounting firms may, by virtue of being named in the audit report, consider themselves to be associated with the report. They may feel it necessary to undertake a wider range of procedures, including reviewing the complete financial statements and SEC filing in which the statements are contained, in order to consider whether other statements in the filings are consistent with the work they performed on the audit or whether other parts of the filing raise association risks. This concern is heightened because the Audit Participant will not provide a separate report and it will not be clear from the face of the audit report what parts of the audit are attributable to the Audit Participant. Performance of these procedures will result in unnecessary costs, as the Audit Participant will be performing procedures and inquiring in areas they were not involved in during the audit.

As with engagement partners, we believe that the process for obtaining consents from Audit Participants may also present logistical problems. As noted above, new consents will be required from all named Audit Participants for every registration statement and amendment after the initial filing of the audit report. The need to obtain consents from numerous non-US firms—and for those firms to perform the necessary procedures in order to be able to issue the consents—could lead to delays in completing the offerings and additional costs.





***“Off-Shoring”***

As with its 2011 proposal, the Board’s current proposal would not require reporting with respect to portions of the audit that are performed by offices of the same registered public accounting firm, even though they are located in a country different than the country where the firm is headquartered. The Board rejected comments on the prior proposal, including ours, recommending that this exclusion should also apply where the same types of off-shored activities are conducted by separately-organized legal entities that are wholly-or majority-owned subsidiaries of the firm or by joint ventures with other firms in their networks. As we pointed out previously, the personnel provided by the subsidiaries or joint ventures perform the audit related tasks under the direction and control of the engagement team that is performing the audit. Because the personnel are acting, in effect, as part of the principal auditor engagement team, we believe it is unnecessary to separately break out the entities that perform the work. These functions differ fundamentally from that performed by other independent accounting firms, who agree with the principal auditor to perform substantive audit procedures with respect to a portion of the entire enterprise being audited.

We fail to see any principled basis for distinguishing between work performed by “offices” of the same legal entity and the work performed by subsidiaries or joint ventures of the type described above. Reporting about the portions of work that are performed off-shore will not provide any meaningful information about the entities that are responsible for those portions of the audit. Most likely, it will only provide a basis for commentary about off-shored activities that have no relevance to investor protection or audit performance. We believe that reporting should not be required for off-shoring arrangements of this type.

**CONCLUSION**

As discussed above, we support the general objective of providing meaningful information to users of the financial statements. However, we have concerns whether the proposals will serve that objective or enhance audit quality. Nevertheless, to be responsive to the requests of users we are supportive of providing the engagement partner and Audit Participants reporting in a place other than the audit report itself, but, to alleviate concerns about who is responsible for issuing the audit report, we also believe that the name of a member or members of firm leadership should also be included. The alternatives outlined above will address many of our concerns while still providing additional information about the audit to users.

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We appreciate the opportunity to express our views and would be pleased to discuss our comments or answer any questions that the PCAOB staff or the Board may have. Please contact Michael J. Gallagher (646-471-6331) or Marc Panucci (973-236-4885) regarding our submission.

Sincerely,

*PricewaterhouseCoopers LLP*