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

12 February 2014

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 Ms. Brown:

Ernst & Young LLP (EY) is pleased to comment on the proposed amendments (the Proposed Amendments or the Proposal) to the Auditing Standards of the Public Company Accounting Oversight Board (PCAOB or Board) aimed at improving the transparency of audits. Our global organization, Ernst & Young Global Limited, joins in these comments which, where applicable, are broadly aligned to its response to the International Auditing and Assurance Standards Board (IAASB) exposure draft *Reporting on audited financial statements: Proposed new and revised International Standards on Auditing (ISAs)*.

We support the PCAOB's efforts to enhance transparency about the auditor's role and responsibilities, including the PCAOB's initiative to revise the auditor's report to provide investors and other financial statement users with information on matters that the auditor considered to be most important to the audit. We continue to support the identification of accounting firms that have a significant role in the execution of the audit and while we believe such information may be useful to investors and other financial statement users, we believe this information should be provided outside of the auditor's report.

However, as we have previously commented, we do not support identifying the engagement partner in the audit report or in a public filing with the PCAOB. In our view, identifying the engagement partner will result in operational challenges, as a result of legal requirements in connection with public offerings that will, of necessity, increase the costs, complexity and amount of time required for a company to access the capital markets, but will not provide meaningful additional information to investors that will offset such costs and challenges. We also believe that this proposal will not improve audit quality and will likely have potentially negative effects on the profession. More importantly, the Proposal appears to send a message that is inconsistent with an appropriate focus on firmwide accountability with respect to audits and audit quality. The execution of an effective audit is a collective effort that can involve many individuals and depends on a variety of factors. In the PCAOB's inspections of our firm, there is appropriate focus on the various elements of our system of quality control and the many factors that influence audit quality overall. We also note the myriad of metrics and engagement components being evaluated as part of the Board's Audit Quality Indicators (AQI) project. The AQI

project highlights the numerous factors contributing to the execution of a quality audit by a firm, many of which extend beyond the control of the engagement partner. We commend the Board on its AQI project and its recognition of the many different factors — across a firm or network of firms — important to the execution of a quality audit. At the same time, we believe that a focus on the identification of the engagement partner may send the opposite signal, and some may inappropriately infer that one person is the key to the execution of a quality audit. This detracts from the important focus on firmwide responsibility.

We believe the proposed identification of the engagement partner is not a constructive concept in view of (1) the uncertain usefulness of this information to financial statement users; (2) the practical challenges that would be created, particularly if the identification is included in the auditor's report and consents are required pursuant to the Securities Act of 1933; and (3) the array of likely harmful consequences to the profession that we believe would result. Accordingly, we recommend the Board drop this aspect of the Proposal.

With respect to the specific consent requirements, the likely operational and liability implications are far more significant than those described in the Proposing Release. If the Board decides to proceed with all elements of the Proposal, we strongly believe that the names of the engagement partner and the other participants would need to be provided outside of the auditor's report, such as in a revised Form 2 filing, to address the many challenges otherwise created by the need for consents.

Engagement partner identification

Inappropriate focus on the partner rather than the firm

We believe identifying the partner does not and will not provide insight into the partner's experiences and relevant skills or the quality of the overall engagement team or the audit itself. The Proposing Release explains that, over time, databases or other sources of information may be developed that will contain additional information about the partner, which would be useful to investors. For example, the Proposing Release states that various sources of information may be created to inform investors whether a particular partner has been associated with past restatements, going concern opinions or private litigation. We question whether the providers or gatherers of this information would have the necessary knowledge or context to appropriately and fairly evaluate such events and accurately depict a partner's competence or diligence. There is a risk that the collection of such data (and whatever is implied by, or inferred from it) will be incomplete and without appropriate context. More importantly, such information has the potential to be misleading and harmful.

Along these lines, the Proposed Amendments discuss the possible formation of "star" ratings in the marketplace after a sufficient amount of data on partners is collected. Rating partners as "stars" would place inappropriate emphasis on the engagement partner, as opposed to the firm and the team as a whole. It is certainly true that the engagement partner leads the engagement team, but, as we noted above, an audit opinion is issued by the firm, not an individual partner, for a specific reason: the execution of an effective audit involves the collaborative efforts of many individuals and must be viewed as the overall undertaking of the firm. While the engagement partner clearly has a significant and undeniably important role, there are many other people with critical responsibilities, such as the engagement quality reviewer, the firm's technical resources and other specialists, and many non-partner-level auditors.

In addition, there are many important elements of an audit that are established and monitored at a firmwide or network level, such as the audit methodology employed, the tools to conduct the audit, the nature and level of firm resources, the hiring and retention of capable talent, training programs, consultation policies and many others. Identification of, and related focus on, the engagement partner (and the concomitant development of "star" ratings) would send a message that is inconsistent with how we view and evaluate the execution of an audit. This concern should not be construed as a lack of focus on audit partner accountability for quality, which we believe is an important component of our system of quality control. Accountability is a key area of focus for us, and we believe audit partners (through internal and external inspection activities and other means) are already highly accountable.

The Proposal also seems to discount, in large measure, the role of audit committees in selecting the individuals to conduct audits of public companies. Audit committees, which have audit oversight responsibilities under the Sarbanes-Oxley Act, spend considerable time evaluating the qualifications of the audit firm, as well as the skills and experiences of the partners and other engagement team members working on the audit. The audit committee is given extensive information about the engagement partner's qualifications and experiences and typically interviews a number of partners before approving the selection of the engagement partner to lead the company's audit. Based on that information, the audit committee determines whether the partner is capable of leading the audit. These decisions involve a thoughtful process and the evaluation of background information such as technical proficiency or industry experience, a process that cannot be replicated by an investor based on the identification of a partner's name.

Consent requirements — liability concerns

The consent requirement will give rise to significant liability concerns. The Proposing Release discusses the liability issue and notes "that any possible increases in a named engagement partner's or participating accounting firm's exposure to liability should be limited and that the potential risk of such an increase would be justified by the potential benefits to investors and other financial statement users of greater transparency."[1] We believe, however, that the risks are not limited and that should the Board decide to move forward with this proposal, it can achieve the same transparency objectives without creating these additional risks.

The requirement that a consent be provided by an individual engagement partner would expose him or her to liability under Section 11 of the Securities Act of 1933, which provides for claims against "every accountant" who "has with his consent been named" as "having prepared or certified" any part of a registration statement or any report used in a registration. This would be an extraordinary change in the current liability regime. Section 11 liability is the most onerous liability provision in the federal securities laws. The leading securities law treatise refers to it as the "bête noire" of the securities laws.[2] Multi-billion dollar legal claims have been based on it and its extension to additional capital market participants would be a major development.

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1 From page 21 of the Proposing Release

2 Loss, Seligman & Paredes, Securities Regulation, § 11.c.2, Aspen Publishers (2013)

The Proposing Release observes that partners should not be concerned about this newly created liability because the accounting firm itself would indemnify the partner for any individual liability and that overall costs would not increase. This overlooks at least three significant issues.

First, at the very least, the addition of defendants in any litigation leads to an increase in litigation costs because each defendant may need separate legal counsel, and additional pre-trial discovery and pre-trial motions are likely to ensue.

Second, it is by no means certain that an accounting firm could fully indemnify a partner who is found liable under Section 11. As the Proposing Release notes (see footnote 50, page 22), Section 14 of the Securities Act prohibits the waiver of compliance with the Act, and an indemnity might constitute such a waiver. At the very least, the imposition of Section 11 liability, coupled with uncertainty over the availability of an indemnity, would create a challenging state of affairs for audit partners being asked to sign a consent (a state of affairs that, it might be noted, has never been extended to attorneys, notwithstanding their substantial and important role in the securities registration process).

Third, the Board seems to assume that every accounting firm would in all instances be capable of indemnifying its partners. But that may not always be the case.

We should also note that it is by no means certain that the named partner would easily avoid Securities Exchange Act of 1934 liability under Section 10(b) and Rule 10b-5, notwithstanding the Board's conclusion to the contrary. Under the Supreme Court's decision in *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2302 (2011), a person cannot be sued under Section 10(b) unless he or she "makes" an allegedly fraudulent statement. The case law construing *Janus* is still developing, and based on the placement of the partner's name in close proximity to the name of the signing firm, coupled with the consent, a plaintiff might allege that the partner did make the challenged statement.

The consent requirement might also aggravate existing liability concerns under state law. Accounting firms such as ours often face claims brought in state court by lenders, bankruptcy or litigation trustees, and others alleging negligence, negligent misrepresentation, fraud or other misconduct in connection with the issuance of an audit opinion. Individual partners are generally not named as defendants in these lawsuits, but linking the partner's name specifically to the audit report may change this. Plaintiffs may also conclude that naming individual partners as defendants would provide them additional leverage for purposes of settlement, would make it easier to obtain discovery from the partner and may provide other tactical advantages.[3] A partner-defendant may believe that it is important to his personal and professional life that a case be settled quickly, potentially increasing the cost of a settlement.

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[3] At the PCAOB's public meeting on 11 October 2011, Chairman Doty noted that auditors of issuers in the EU are required to personally sign the audit opinions, and he questioned why the rules in the US should be different. But we submit that the litigation environments in the US and Europe are very different. Lawsuits against auditors are brought in the US much more often. We respect the fact that a requirement for audit partners to sign opinions exists in other countries. However, we do not believe those precedents should be controlling relative to a decision on this concept in the U.S., particularly in view of the significantly different legal environments. In Ernst & Young Global Limited's response to the IAASB on the disclosure of the name of the engagement partner, it did not support an international requirement for disclosure of the engagement partner's name in an auditor's report as it did not believe it is necessary or adds to the quality of the audit.

In this regard, as we discussed in our previous comment letter, the naming of an individual partner as a defendant, particularly in a Section 11 lawsuit in which damages claims could be in the billions of dollars, is likely to have a devastating effect on a partner personally. The ability of a partner to obtain a mortgage loan, to get his or her accounting license renewed, or to engage in other activities may be impaired while the litigation is pending. And the consequences may be long-lasting. In an age of immediate internet search capability, the ability of an individual partner to overcome the negative effects of litigation (including frivolous suits and cases won by the defendant auditor) could be challenging because the partner's livelihood depends on his or her professional reputation.

Consent requirements — operational difficulties

We raise the liability issues stemming from the consent requirements in large part because of the operational difficulties that will result. For example, a former partner may be unable to sign a consent after his/her departure from the firm (through retirement or otherwise). If the partner moves to another auditing firm, there could be numerous legal issues associated with signing a consent, including the terms of the partner's new employment and client confidentiality issues.

Problems also could arise if a lead audit partner[4] is required to sign a consent after rotating off the audit as required by the Sarbanes-Oxley Act and SEC independence rules (i.e., the partner has completed his or her five years of service on an engagement, and a consent is required prior to completion of the subsequent year's audit). EY's policies and procedures require that certain post-report review procedures be performed through the date of filing a registration statement and the effective date of such registration statement (or as close thereto as reasonably practicable) in order to satisfy Section 11 due diligence requirements. However, a lead audit partner who has completed his or her five years of service would be in a time-out period under the SEC independence rules. This means he or she would not be permitted to participate in the completion of the required procedures and therefore would not be in a position to sign a consent. We believe that requiring the lead audit partner in this situation to sign a consent also requires that partner to oversee and be responsible for the performance of certain post-report review procedures during his or her time-out period. Those activities would be inconsistent with the SEC independence rules on partner rotation in Regulation S-X, Rule 2-01(c)(6) and could also delay the start of the time-out period for the lead audit partner unless clarification is provided by the PCAOB and SEC.

Assuming these challenges could be overcome, having a partner who has taken on other responsibilities within the firm, possibly in other regions or countries, to be on call to perform appropriate due diligence procedures and issue consents, within the very short time periods provided by issuers in this context, would be impractical. These challenges could result, at the very least, in increased time, effort and cost of the registration process, which could create timing delays and increased costs for issuers.

Other effects on partners and the profession

We also believe that if this Proposal were adopted and audit partner star ratings were developed, the profession as a whole would be negatively affected. With the Proposal's contemplated development of databases that would track engagement partner history and match names to specific events, it could

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[4] As defined in Regulation S-X, Rule 2-01(f)(7)(ii)(A).

be much harder for certain partners to assume the responsibility of signing partner on public company audits. It is possible that some audit committees might prefer not to have to explain why a new signing partner does not have a database history. This could potentially steer some audit committees away from an otherwise qualified partner, who may have served as a non-signing partner on a number of public engagements or as a signing partner on private company audits. This could be harmful to the profession's ability to attract and develop audit talent and pose challenges to the ongoing staffing at the partner level of public company audits.

Partners may also find themselves being negatively affected and held accountable for situations that are beyond their control, or may in actuality be evidence of the partner's fortitude in dealing with difficult client situations. For example, if a company restated its financial statements or the audit firm issued an audit report identifying a material weakness or including a going concern explanatory paragraph, the market would be left to determine whether these events should reflect favorably or unfavorably on the partner. Moreover, not all restatements are the same. As the Board knows, there can be many different reasons (and root causes) behind a restatement. In the context of reasonable assurance, some accounting errors will arise and not be detected through an audit conducted fully in accordance with PCAOB standards. In certain cases, a restatement will result from a new partner challenging the legacy accounting conclusion employed by an entity. Some restatements occur as a result of changes in interpretations by the SEC staff. In other cases the restatement may relate to a matter that should have been previously discovered through the audit process and the audit partner should be considered partially responsible.

The contemplated databases will be unlikely to be able to determine the root cause(s) of a restatement and the potential responsibility of the current or former engagement partner. Black marks could be assigned that will not be consistent with, or be an appropriate measure of, a specific partner's performance or focus on audit quality. As a result, the Proposed Amendments may negatively affect individuals who executed their work to high standards. This reality will hurt the profession's ability to retain talented individuals who, as was previously described, already feel highly accountable for audit quality and the types of events noted above.

The profession is in continuous need of skilled auditors. The issues discussed above will likely make the profession less attractive to new entrants. Such issues may lead some persons already in the profession to question whether continued participation is worth the increased risks. Both dynamics could lead to a decrease in audit quality over the longer-term.

Identification of other participants in the audit

We continue to support the goal of providing greater transparency about other participants in the audit and are pleased that the Proposed Amendments incorporate certain suggestions that we and others made to somewhat reduce the administrative burden associated with capturing and reporting this information. However, given the position expressed by the PCAOB in the Proposal that a written consent would be required from the named other participants, we do not support including such information in the auditor's report.

For the same reasons discussed above with respect to an individual partner, the consent requirement would expose the named firms to increased legal liability and litigation costs. Litigation costs would likely increase significantly if multiple accounting firms were named as defendants (as they surely

would be if the Section 7 written consent were required). Each firm would likely need to hire its own legal counsel, and such a lawsuit would likely lead to difficult disputes over each named firm's level of responsibility. Courts would likely need to determine the relative responsibility of each defendant and possibly resolve difficult jurisdictional issues involving non-US accounting firms. In this regard, the consent requirement may cause concern among foreign firms about being drawn into US litigation, which until now they have largely avoided.

The consent requirement would also likely create significant practical challenges for issuers in obtaining consents from numerous other firms, even network firms (especially due to the proposed threshold for being named in the auditor's report being lower than the 20% threshold for "substantial role firms"). While the Board believes that "the requirement to file a consent does not change the work the auditor must do,"[5] in fact, each firm would have to present its own due diligence defense under Section 11 and duplication of procedures would likely ensue, increasing overall effort, time and costs. For example, standard practice today is that only the signing audit firm reads the registration statement before filing. Under the Proposed Amendments, it is likely that a participating firm would not consent to being named in the auditor's report to be included or incorporated by reference in a registration statement without also reading the registration statement and performing additional procedures (e.g., subsequent event type procedures, obtaining legal letters, obtaining letters of representations). This could drive numerous firms to perform the same or similar procedures. This would lead to increased costs and would be time-consuming, resulting in an increase in the amount of lead time necessary for companies to raise money in the market. This challenge would exist even in a globally integrated organization such as ours. We would expect that less-integrated organizations would have significantly more issues in this regard.[6]

To estimate the effect of these requirements, we performed an informal survey of a group of our large issuer audit teams and found that approximately 85% of companies currently give us 15 days or less of lead time to file our consent when registering additional debt or equity (approximately 25% give us five or fewer days). At the 5% threshold reflected in the Proposal, this same survey revealed that in approximately 20% of these audits, more than three firms would be required to provide a consent. At a threshold of 10%, consents would be required by more than three firms in approximately 5% of the audits. As previously noted, updated subsequent event procedures are required to be completed as of the date of filing and effectiveness of a registration statement. We would expect that coordination of this effort would result in additional time being required to obtain consents, causing potential delays in an issuer's ability to raise capital.

These challenges would not increase overall audit quality but would duplicate procedures and increase costs. The Proposal does not sufficiently reflect an assessment of such costs.

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[5] From pages 23 and 24 of the Proposing Release

[6] The same issue under Section 10(b) discussed above with respect to individual partners would also exist for other named accounting firms. Indeed, plaintiffs' counsel have tried in many lawsuits to extend liability from a signing firm to other firms in a global organization or to the global organization itself; including the names of other network member firms in the audit opinion would likely add grist to this litigation mill.

Alternatives to identification in the auditor's report, and a reasonable threshold

As discussed, we support the identification of other participants but do not support identification of the engagement partner name. If the Board chooses to move forward with this Proposal, we recommend that any such information should be provided outside of the auditor's report. Firms could be required to provide such information in individual filings with the PCAOB on a periodic basis within a reasonable period of time after the completion of an audit. If such an approach were adopted, we also suggest additional information be included regarding the relationship between the lead audit firm and other participants in an effort to provide financial statement users a greater understanding of this important dynamic. We believe that the proposed threshold of identifying other participants with audit hours of 5% or more is too low. A threshold of 10% will be more practical and still achieve the Board's increased transparency objectives in this area. Further, we suggest that the ranges be increased to increments of 20%, which we believe are practical and give interested parties a fair frame of reference of other participants in the audit. In addition, those firms that play a "substantial role" in the engagement (as defined by the PCAOB) could be so identified.

We discuss these points below:

The Board's principal objection to using Form 2 as an alternative to identification of these parties in the auditor's report involves the timeliness of any information that is provided in Form 2. We think this concern can be addressed by a rule that establishes a separate reporting form that could be filed with the PCAOB on a periodic basis within a reasonable period of time after the completion of an audit.

We believe that this would be the best method of providing this information to investors. It would allow timely and relevant information to be provided but would avoid the numerous complications resulting from the consent requirements. The costs of implementing a mechanism for timely reporting would not require significant additional effort or cost beyond the cost associated with collecting the information (especially if the threshold were raised higher as noted below).

The Board suggests that there are two other disadvantages to this approach: Financial statement users would have to search in two regulator websites (SEC and PCAOB) to get the full picture, and the PCAOB would incur additional costs to administer such a system. We believe that these concerns are minor compared with the significant practical challenges and liability concerns that would result from the disclosure being included in the auditor's report. Currently, financial statement users review a large variety of sources when making decisions. Investors combine financial statement information with news, analyst reports, macro-economic data, price history and other data when making decisions. Adding a website to this process would not be a significant burden. In fact, if the information were provided in a machine-readable format, processing this information would likely be easier for financial statement users than having to sort through each auditor's report to try to obtain relevant information.

We present in an attachment to this letter an example that could be included in the form to incorporate the concepts above.

We also recommend that the requirements be expanded to adequately acknowledge the signing firm's oversight, supervision and review responsibilities over those other participants in the audit. We believe investors would benefit from gaining a general understanding of the relationship between the signing

firm and other participants in the audit and the signing firm's professional responsibilities for the work performed by the other participants. Some firms are part of a loose network of legal entities, while other firms (such as EY) are members of a global organization that requires all members to follow a consistent audit methodology and adhere to a similar system of quality control. In other circumstances, such as in situations where a non-network firm's work is relied upon by the signing firm, the participating firm is outside of the signing firm's organizational structure and does not follow a similar methodology. We believe investors should be provided information so they can understand the relationship and commonalities, or lack thereof, between the other participants and the signing firm.

Finally, we acknowledge that the Proposed Amendments reflect an increase in the reporting threshold from the original proposal. However, as noted above, we believe the threshold should be increased further because we do not believe naming firms with participation of less than 10% would provide that much additional benefit to investors. Based on our internal survey, on average the number of participating firms identified at the 10% level is 50% fewer than at the 5% level. This significant drop in the number of named participating firms would be especially critical if the Board were to adopt the Proposal requiring identification within the auditor's report, which would cause consents to be required. Although moving this information into a separate form would reduce some of the practical challenges, we believe increasing the threshold would remain appropriate.

Applicability to emerging growth companies

We support consistency in the application of auditing standards to all issuer audits, including audits of emerging growth companies (EGCs) and broker/dealers. We believe consistency reduces the potential for marketplace misunderstanding. We also believe that the information regarding other audit participants would be equally useful to investors in both EGCs and non-EGCs. While not supporting the concept, if the PCAOB decides to require partner identification for issuer audits, we do not see any compelling conceptual argument for why such a requirement should not apply to EGCs. That being said, we recognize the PCAOB must perform a cost-benefit analysis related to any standard that would affect an EGC audit, and we believe the Board will face considerable challenges in demonstrating that the benefits exceed the costs. As noted above, we do not see compelling evidence that the Proposal would have discernable benefits (across all public company audits), while strong evidence exists that the Proposal will likely impose significant costs on all entities.

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We want to again thank the Board for its consideration of this letter and the comments we previously submitted on this topic. We urge the board to consider our views in its deliberations on the Proposal. We would be pleased to discuss our comments with members of the Board or its staff.

Respectfully submitted,

Ernst + Young LLP

cc:

PCAOB
James R. Doty, Chair
Lewis H. Ferguson, Board Member
Jeanette M. Franzel, Board Member
Jay D. Hanson, Board Member
Steven B. Harris, Board Member
Martin F. Baumann, Chief Auditor

SEC
Mary Jo White, Chair
Luis A. Aguilar, Commissioner
Daniel M. Gallagher, Commissioner
Michael S. Piwowar, Commissioner
Kara M. Stein, Commissioner
Paul A. Beswick, Chief Accountant
Brian T. Croteau, Deputy Chief Accountant
Julie Erhardt, Deputy Chief Accountant
Daniel Murdock, Deputy Chief Accountant

Recommended Form Contents:

Exact name of Registrant as specified in its charter**: ABC Company, Inc.**

Period of most recent financial statements filed with the Securities and Exchange Commission:

Consolidated Financial Statements of ABC Company, Inc. as of December 31, 20XX and for the year then ended

*Commission file number**: 000-XXXX***

Description of responsibilities:

> On xx/xx/xx, the above referenced financials were filed with the SEC. We are responsible for our opinion on the consolidated financial statements of ABC Company [and the effectiveness of internal control over financial reporting of ABC Company]. In conducting our audit of the consolidated financial statements, we used the services of other independent registered public accounting firms that may or may not be affiliated with us through our global network.[7] [Each member firm that is part of the network is a separate legal entity. However, all member firms follow a consistent audit methodology and are subject to a similar system of quality control.[8]] We, as the signing firm, take responsibility for the audit procedures performed by the other independent registered public accounting firms [other than firms being referred to] and, accordingly, have supervised or performed procedures to assume responsibility for their work in accordance with PCAOB standards. We requested the other participants, either included within our global network or outside our global network to conduct certain audit procedures in support of the audit of the consolidated financial statements [and effectiveness of internal control over financial reporting]. The audit procedures performed by other affiliated and non-affiliated participants represented approximately xx% and xx%, respectively, of total estimated hours involved in our audit of the consolidated financial statements on ABC Company as of and for the year ended December 31, 20xx. The listing of these other participants, as well as information regarding their affiliation and jurisdiction, is included below. The firms indicated with an asterisk are located in jurisdictions where, as of the date of this report, the PCAOB cannot perform inspections. The firms that played a substantial role on the engagement, as defined by the PCAOB, are identified with an [s].

Listing of participants:

Range of total estimate audit hours:	Firms within range
10% — less than 30%	
30% — less than 50%	
50% — less than 70%	
More than 70%	

[If no other participants were involved in the audit, the information above would be replaced with form identification information and the following sentence: We did not use the services of other independent registered public accounting firms in conducting our audit.]

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[7] Language would be based on the specific facts and circumstances of an audit.

[8] Each firm would describe its member network affiliation.