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

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. Secretary:

We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB or the Board) 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* (the PCAOB Release or the Proposal).

The Board has requested public comment on amendments to its standards that are intended to improve transparency of public company audits. The PCAOB Release would require communication in the auditor's report of (1) the name of the engagement partner on the most recent period's audit and (2) the names, locations and extent of participation of other independent public accounting firms that took part in the audit and the locations and extent of participation of other persons not employed by the auditor who performed procedures on the audit.[1]

Overview

As noted in the PCAOB Release, the "Board believes that disclosure of the identity of the engagement partner, as well as enhanced transparency about other participants in the audit, would provide investors with information about the audits conducted for their benefit that they would find useful. The Board also recognizes that many investors … believe that these measures would prompt engagement partners to perform their duties with a heightened sense of accountability to the various users of the auditor's report."[2] As originally noted in our comment letter dated January 5, 2012 on PCAOB Rulemaking Docket Matter No. 029, *Improving the Transparency of Audits: Proposed Amendments to PCAOB Auditing Standards and Form 2* (the Prior Release), which we incorporate by reference here, we do not

[1] Per the Proposal, the name and location of other independent public accounting firms that took part in the audit and the location of other persons not employed by the auditor who performed procedures on the audit would not need to be communicated if their level of participation (individually for firms and in the aggregate for persons from the same country) was below five percent of the total hours as of the date of the auditor's report.

[2] Proposal at 5.

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believe that the proposed disclosure of the name of the engagement partner would increase the engagement partner's sense of accountability, improve audit quality or result in independent public accounting firms enhancing their system of quality control (e.g., through changes to the assignment protocols for an engagement partner). Also, we question how useful such information would be to investors and other financial statement users,[3] particularly in light of the risk that it could mislead more than it informs (e.g., it could create an inappropriate implication that the engagement partner is responsible for such matters as the effective operation of firm-level quality controls) and the fact that the mere disclosure of a partner's name provides no insight into the full experience and expertise of the engagement partner. Accordingly, we again recommend that the engagement partner's name not be subject to required disclosure.

Although we support the Board's proposed communication of certain information about independent public accounting firms and other persons not employed by the auditor that took part in the audit, we continue to believe, as noted in our comment letter on the Prior Release, that such communication should be made outside of the auditor's report. Requiring that the information be included in the auditor's report will increase litigation risk and result in challenges to obtaining consents. If the Board determines to require disclosure of the engagement partner's name in the auditor's report, these concerns are multiplied. The remainder of this letter examines the litigation risk and consent issues, as well as some other issues, in greater detail.

Litigation Risks Raised by Naming the Engagement Partner and Other Participating Audit Firms in the Auditor's Report

In its Concept Release on this subject, the Board stated that its intent was <u>not</u> "to increase the liability of engagement partners,"[4] but the Board now assumes that its amendments will do just that.[5] Indeed, the possibility that engagement partners and other participating audit firms named in the auditor's report will be subject to liability under Section 11 of the Securities Act is a significant risk, because liability under

[3] One of the studies cited in the Proposal gives an empirical basis for this concern. See Tamara A. Lambert, Benjamin L. Luippold and Chad M. Stefaniak, *Audit Partner Disclosure: Potential Implications for Investor Reaction and Auditor Independence.* In what appears to be the only study to examine the question, the results indicated that the more familiarity an investor had working with financial information, the less importance was attached to the name of the engagement partner.

[4] Release No. 2009-005, *Concept Release on Requiring the Engagement Partner to Sign the Audit Report*, at 11. See also, Proposal at 20 ("[T]he Board has not sought to increase the risk that an engagement partner would be held liable in private litigation . . . ").

[5] Proposal at 21-22. We are not convinced, however, that the assumption that engagement partners and participating audit firms that are named in the auditor's report will need to consent to the inclusion of their name in the auditor's report is correct. In the eighty years that Section 11 has been in place, neither engagement partners nor named participating audit firms have been thought to fall within its purview because auditors do not prepare financial statements and only the firm issuing the auditor's report issues a report or certification.

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Section 11 is intentionally onerous and defenses are limited. Instead of addressing this specifically unintended result with particularity, the Proposal concludes 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 . . .".[6] The conclusion appears to be drawn arbitrarily, especially when, as noted above, the increase in liability runs entirely afoul of the stated intention of the Board and, as noted below, there are methods of achieving the desired benefit without increasing the risk of liability and associated costs, which are in no way limited.

Communication of Information Through the Auditor's Report

There are logistical challenges that could arise from the need to obtain a consent from an engagement partner or a participating audit firm that is named in the auditor's report, which would be alleviated if the information is communicated outside of the auditor's report.

The majority of logistical challenges would arise in situations where the engagement partner from whom a consent is required is no longer associated with the firm that issued the auditor's report. In such situations, the former engagement partner may not agree to issue a consent or may be unable to perform whatever procedures that may be considered necessary to issue a consent (i.e., update procedures). This would have significant implications on the ability of the issuer to file a registration statement on a timely basis.

Additionally, because a consent might subject a named participating audit firm to costly litigation, regardless of outcome, it is reasonable to assume that a firm would want to review the document subject to the filing and possibly perform update procedures prior to issuing a consent. Because each named firm may face litigation, each may want to conduct update procedures, even where such procedures are duplicative of each other. Depending on the number of named firms that were involved in the audit, this could delay the registration statement filing process, while increasing its costs.

Costs of Proposed Approach

The costs of pursuing a regulatory scheme that increases an engagement partner's and named participating audit firm's exposure to private litigation are not "small,"[7] as the PCAOB Release concludes. Even if the engagement partner and firms are joined in a "lawsuit that would have been filed anyway,"[8] multiplying parties will multiply the number of issues to be resolved. The litigation will have to determine, for each participant, which part of the filing it might (and might not) have purported to certify. Because different participants would have had different tasks and performed their services in

[6] Proposal at 21.

[7] Proposal at 22.

[8] Proposal at 23.

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different jurisdictions, the litigation will have to determine which law applies to which actions. Litigation also is likely to raise complex cross-border discovery disputes. Because the interests of the additional parties may not be identical to the interests of the signing independent public accounting firm, it seems likely that any Section 11 litigation will require multiple counsel representing the different interests, itself necessitating substantial added cost.[9] Additionally, the Proposal assumes that, if a judgment would be entered against an individual engagement partner, "the accounting firm will have greater resources to satisfy a judgment than will any individual partner," and that the firm will, in fact, satisfy the judgment instead of leaving it to the individual to do so.[10] This may be the case with larger firms, but the assumption would not be as sound in the case of smaller firms.

Finally, requiring the disclosure of the information in the auditor's report likely will increase costs associated with obtaining consents from the named parties, including costs associated with update procedures and delayed filings.

Alternatives to Providing Information in the Auditor's Report

As noted in our comment letter on the Prior Release, Form 2 provides an appropriate vehicle for providing the information that is the subject of the Proposal, without increasing the risk of litigation or imposing the logistical challenges detailed above. The purported disadvantages to Form 2 reporting cited in the PCAOB Release – the timeliness of the communication, the cost to compile and report the information, and a concern that it would make the information more difficult for investors and other financial statement users to find[11] – certainly can be addressed.

Although the PCAOB Release states that this information should be reported more quickly than the current deadline for Form 2 filings, the PCAOB could solve that issue by simply setting a different deadline for certain aspects of the Form 2 data (i.e., the name of the engagement partner and/or certain information about other participants in the audit), with such information being filed with the PCAOB on a periodic basis throughout the year. Alternatively, the PCAOB could introduce a new reporting form to gather the above information, and such form could be required to be submitted on a periodic basis throughout the year.

[9] The Proposal, at 22 n. 50, suggests that, in certain cases, indemnification may not be available to individuals. If indemnification were not available, the actual costs of defense for any individual defendant in a securities action will be significant to that individual, not to mention the additional adverse impacts associated with being named as a defendant in a lawsuit. The potential costs to individuals – tangible and intangible – do not appear to be contemplated fully by the Proposal.

[10] Proposal at 22.

[11] Proposal at 33-34.

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With respect to the additional costs that will be incurred by firms, although firms will incur initial costs to develop processes to gather the information, those costs are unlikely to change significantly based on where the information is reported ultimately.

Finally, with respect to the convenience of locating the information, we do not believe it would be any more difficult for an interested investor or other financial statement user to find a particular company in Form 2 than it would be for that person to find a particular company's public filings on EDGAR. One of the studies cited in the PCAOB Release indicates that investors do read and consider the information on Form 2.[12] Regardless of where the name of the engagement partner is reported, it cannot become meaningful information unless combined with other information from other sources, as the PCAOB Release acknowledges.[13] There is no reason to believe that investors and other financial statement users with sufficient interest to research an engagement partner's history would find Form 2 daunting.[14] To the contrary, communicating the information by way of Form 2 may be more convenient, in that it would allow investors and other financial statement users the ability to identify other issuers with which the engagement partner is currently, or has been, involved.

Other Matters

Calculating Participation Percentages

We believe that the modification that the PCAOB made in the Proposal, to allow for the use of a range for purposes of communicating the level of participation of a participating audit firm and other persons not employed by the auditor that took part in the audit, will help alleviate some of the issues that would have been present if only a single number was required. Notwithstanding this change, we believe additional guidance is needed from the PCAOB as to how to separate the audit hours incurred by a participating audit firm when such firm performs work both in connection with the consolidated audit as well as for statutory audit reporting purposes.

In addition, we believe additional guidance from the PCAOB is required as to how to calculate the level of participation for those situations where a participating audit firm audits an equity method investee of the issuer (assuming that the independent public accounting firm that issued the auditor's report at the issuer level assumes responsibility for the work of the participating audit firm). As an example, should the hours for the participating audit firm that audits the equity method investee reflect the total hours incurred on that engagement, or should such hours be weighted by the ownership level held by the issuer in the equity method investee? Also, situations could arise where the independent public accounting firm

[12] Proposal at 30-31 and n.70.

[13] See, e.g., Proposal at 11.

[14] The Board makes finding information on Form 2 simple. A "hot-linked" section index to each Form 2 is provided, and the forms are word searchable.

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that issues the auditor's report at the issuer level may not be able to obtain information about the hours attributable to the participating audit firm that audits the equity method investee, which would further complicate being able to perform the calculation that is required to determine the level of participation by such firm.

Scope

If adopted by the Board and approved by the SEC, the Proposal would apply to non-issuer brokers and dealers that will be required to be audited in accordance with PCAOB standards for fiscal years ending on or after June 1, 2014. We recommend that the Board exempt non-issuer brokers and dealers from the requirements of the Proposal. As noted in the PCAOB Release, the ownership of brokers and dealers is primarily closely held (per the PCAOB's Office of Research and Analysis, approximately 75% of the brokers and dealers have five or fewer direct owners), and the direct owners are generally part of the entity's management.[15] Therefore, the informational needs of these individuals would typically be different from those of an investor in a widely-held publicly traded company.

We believe that the Proposal should be applicable to emerging growth companies, and therefore recommend that no exemption from the amendments to the standards be provided for such companies, if the PCAOB decides to proceed with the Proposal.

Offshoring Arrangements

We are supportive of the approach that the Proposal takes with respect to the disclosure of offshoring arrangements whereby disclosure is not required when the work is performed by "offices of the accounting firm . . . in a country different than the country where the firm is headquartered."[16] However, we believe that "office" should be defined to include, and disclosure should not be required when, an entity performing the work is controlled by the accounting firm that issues the report, even if that entity is legally distinct from such firm. Whether the accounting firm issuing the report controls the work of the employees of the other entity is the important factor for investors to consider, not corporate formation formalities.

* * * * * * * * *

We appreciate the Board's careful consideration of our comments, and support the Board's efforts to improve the transparency of public company audits through the communication of certain information about other participants in the audit. If you have any questions regarding our comments included in this letter, please do not hesitate to contact George Herrmann ((212) 909-5779 or gherrmann@kpmg.com) or Rob Chevalier ((212) 909-5067 or rchevalier@kpmg.com).

[15] Proposal at 27.

[16] Proposal at A3-12.

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Very truly yours,

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