CENTER FOR CAPITAL MARKETS COMPETITIVENESS

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

Re: PCAOB *Proposed Auditing Standard – Related Parties, Proposed Amendments to Certain PCAOB Auditing Standards Regarding Significant Unusual Transactions, and Other Proposed Amendments to PCAOB Auditing Standards* (PCAOB Release No. 2012-001, February 28, 2012 and PCAOB Rulemaking Docket Matter No. 038)

Dear Ms. Brown:

The U.S. Chamber of Commerce (the "Chamber") is the world's largest federation of businesses and associations, representing the interests of more than three million U.S. businesses and professional organizations of every size and in every economic sector. These members are both users and preparers of financial information. The Chamber created the Center for Capital Markets Competitiveness ("CCMC") to promote a modern and effective regulatory structure for capital markets to fully function in a 21st century economy.

The CCMC believes that businesses must have a strong system of internal controls and recognizes the vital role external audits play in capital formation. The CCMC supports efforts to improve audit effectiveness and appreciates the opportunity to comment on the Public Company Accounting Oversight Board ("PCAOB") *Proposed Auditing Standard – Related Parties, Proposed Amendments to Certain PCAOB Auditing Standards Regarding Significant Unusual Transactions, and Other Proposed Amendments to PCAOB Auditing Standards* ("the Proposal").

The CCMC has some concerns about various aspects of the proposal, particularly the possibility of creating an expectation gap, possible overreach into corporate governance, use of release text and a failure to provide a cost benefit analysis. The CCMC believes that some minor additions could resolve the potential expectation gap and believes that the PCAOB should discuss the proposal with the various regulators that are considering or will soon propose executive compensation related regulations.

The CCMC concerns are discussed in more detail below.

I. Executive Compensation

The CCMC has long advocated that the PCAOB review existing auditing standards and make revisions to them if needed. So at the outset we are pleased that the PCAOB has undertaken the opportunity to review the existing standards and release the Proposal.

The Proposal includes proposed amendments to existing PCAOB auditing standards that would add requirements for auditors to perform procedures to obtain an understanding of the company's financial relationships and transactions with its executive officers, including executive compensation. While the Proposal states that the intent of this added requirement is to assist the auditor in identifying and assessing risks of material misstatement, media coverage of both the PCAOB's open meeting on February 28, 2012 and the Proposal itself reveals that this intent is not well understood. Indeed, the Proposal appears to be creating an expectation gap in regards to the auditor's role and responsibilities related to executive compensation.

Such an expectation gap can sow confusion amongst auditors, investors and businesses and frustrate the intent of the PCAOB in issuing the proposal. To help mitigate this gap, it might be useful to include the following statement from release text in the rule itself (perhaps as a footnote):

> *These proposed audit procedures are not intended to call into question the policies and procedures of the company, but rather to assist the auditor in identifying and assessing risks associated with a company's financial relationships and transactions with its executive officers,*

including unrecognized compensation, illegal acts, or other matters (e.g., self-dealing or conflicts of interest).[1]

The Proposal also states that the procedures the auditor should apply with respect to executive compensation include reading proxy statements and other relevant company filings with the Securities and Exchange Commission ("SEC"). However, the proxy statement would likely be drafted and certainly would be filed subsequent to the completion of the audit. And, the executive compensation sections of the annual proxy statement largely contain historical information—that is compensation information related to the most recent period for financial statements included in Form 10-K filed with the SEC. It would seem that executive compensation information contemporaneous with the period under audit would be most useful for informing the auditor's identification and assessment of risk of material misstatement. Thus, while there may be other reasons for the auditor to read the proxy statement, it is not clear how doing so would accomplish the stated purpose with respect to executive compensation.

While we acknowledge that the Proposal is based upon and revising existing audit standards, the CCMC has expressed concerns regarding the possible encroachment of the PCAOB into areas of corporate governance that is within the purview of state corporate law, or under federal legislation, such as the Sarbanes-Oxley Act ("SOX") within the jurisdiction of the SEC. Under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") the SEC is involved in or expected to propose a series of regulations on executive compensation including incentive based compensation in the financial services industry, pay for performance disclosures, pay ratio disclosures and independent compensation committees. The proposed incentive based compensation regulation is a joint rulemaking of several financial regulators.

The CCMC of course believes that the PCAOB should act within the bounds of its jurisdiction. However, we believe that the PCAOB should also coordinate with these regulators to understand how the proposals interacts with expected regulatory changes and if any changes to the proposal should be made as a result.

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[1] See *Proposed Auditing Standard – Related Parties, Proposed Amendments to Certain PCAOB Auditing Standards Regarding Significant Unusual Transactions, and Other Proposed Amendments to PCAOB Auditing Standards ("Release")* Page A4-44.

Finally in regards to executive compensation, the Proposal maintains the PCAOB's existing audit requirements regarding the auditor obtaining an understanding of compensation arrangements with senior management other than executive officers. However, in doing so, the PCAOB needs to provide clarity on what is meant by senior management. While the Proposal includes a definition of executive officers, it does not define senior management or indicate how senior management would differ from executive officers (and existing auditing standards do not either).

II. Use of Release Text

The CCMC is concerned, as we have written before,[2] about the use of release text to modify a standard and provide guidance and interpretations not found in the standard itself. One very important example of this in the Proposal involves the objective of the proposed related party standard.[3]

Certainly an objective can guide the PCAOB in developing and drafting a proposed standard and, as such, would also guide the auditor in complying with a promulgated standard. However, instead of articulating that complying with the requirements of the proposed standard would meet the objective of the standard, the release text of the Proposal suggests that the auditor must somehow exercise judgment to meet the objective of the standard over and above complying with the requirements of the standard itself.

Essentially the release text articulates a policy statement with regards to an objective, which is not only new but inconsistent with previous statements by the PCAOB. Such a statement is misplaced in the release text of an exposure draft. Moreover, it would require open, thorough, and transparent due process before being articulated as a policy. The notions articulated in the release text appear to open the

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[2] For example, see the March 2, 2010 letter from the United States Chamber of Commerce Center for Capital Markets Competitiveness to the PCAOB on the *Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk* (PCAOB Rulemaking Docket Matter No. 026) and the February 29, 2012 letter from the United States Chamber of Commerce Center for Capital Markets Competitiveness to the PCAOB on the *Proposed Auditing Standard Related to Communications with Audit Committees* (PCAOB Rulemaking Docket Matter No. 030).

[3] See release Page A4-4.

door to enabling PCAOB inspections to generate deficiencies and to otherwise extend auditor liability. The CCMC cannot support such notions.

As we have previously stated, the CCMC recognizes that the release text has merit, particularly in exposure drafts of proposed standards, as it can facilitate better public input. Nonetheless, since release text in any final standard will be referenced by plaintiff attorneys, PCAOB inspectors, and other regulators as a touchstone for the PCAOB's intent, we encourage the PCAOB to be very cautious and transparent in crafting release text for adopting standards.

Finally, there are examples provided in release text of the Proposal that should be included in the standard itself. To illustrate, the release text includes examples of other procedures performed during an audit that may help with the identification of significant unusual transactions.[4] These examples should be included in the amendments proposed to AU sec. 316 *Consideration of Fraud in a Financial Statement Audit* (pp. A2-6 and 7).

III. Significant Unusual Transactions

Proposed amendments to existing auditing standards in the Proposal would change the definition of significant unusual transactions. For example, currently AU sec. 316.66 states:

> ***Evaluating the business rationale for significant unusual transactions.*** *During the course of the audit, the auditor may become aware of significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual given the auditor's understanding of the entity and its environment. The auditor should gain an understanding of the business rationale for such transactions and whether that rationale (or lack thereof) suggests that the transactions may have been entered into to engage in fraudulent financial reporting or conceal misappropriation of assets.*

On the other hand, the Proposal would replace the existing paragraph with the following:

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[4] Ibid, Page A4-33

> ***Evaluating whether the business purpose for significant unusual transactions indicates that the transactions may have been entered into to engage in fraud.*** *Significant transactions that are outside the normal course of business for the company or that otherwise appear to be unusual due to their timing, size, or nature ("significant unusual transactions") may be used to engage in fraudulent financial reporting or misappropriation of assets.*[5]

Not only does the Proposal eliminate the touchstone for "unusual" based on the entity and its environment, but release text goes on to explain that significant unusual transactions need not be infrequent, rather a significant unusual transaction could occur quarterly or more frequently.[6] On the face of it, this appears counter-intuitive and will likely contribute to ambiguity down the road about what constitutes a significant unusual transaction.

An additional problematic aspect of the proposed amendments related to significant unusual transactions includes the expanded list of factors (from AU sec. 316.67) that the auditor should evaluate as to the business purpose of significant unusual transactions (pp. A2.7 and 8). For example, the factor *an accounting for a transaction that enables the company to achieve certain financial targets* is a broad catch-all that could sweep-in a variety of unintended transactions.

IV. Other Matters

The Proposal states the Board anticipates that the proposed standard and proposed amendments would be effective for audits of financial statements for fiscal years beginning on or after December 15, 2012. This proposed effective date is not unreasonable as long as the PCAOB adopts and the SEC approves a final standard before the end of 2012.

V. Cost Benefit Analysis

The Proposal does not contain a cost-benefit analysis and commenters are therefore unable to ascertain what the estimated costs are and the burdens that will be

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[5] Ibid, Page A2-6

[6] Ibid Page A4-30. An additional subtlety here is that the Proposal appears to turn significant unusual transactions from an indicator of a fraud risk (see AU sec. 316.85) to a fraud risk per se.

placed upon businesses and auditors as a result of the proposal. This inhibits the ability of commenters to provide the PCAOB with a fully informed analysis that could lead to beneficial changes in the Proposal.

Concluding Remarks

Once again, the CCMC appreciates the opportunity to comment on the Proposal. We believe that the proposal is an important step in reviewing existing standards and revising them if needed.

While the CCMC has concerns regarding the Proposal, we believe that improvements can be made to reduce the expectation gap and provide clarity for all stakeholders involved in financial reporting and that comments to the Proposal would be more informed with a public cost-benefit analysis. Also, the CCMC believes that the PCAOB should have discussions with regulators concerning executive compensation regulations currently under consideration and that the PCAOB should avoid any potential over-reach into executive compensation and corporate governance regulation.

Thank you for your consideration and the CCMC stands ready to assist in these efforts.

Sincerely,

Tom Quaadman