

American Federation of Labor and Congress of Industrial Organizations



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February 14, 2005

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

Re: PCAOB Rulemaking Docket Matter No. 017

Dear PCAOB Board Members:

On behalf of the American Federation of Labor and Congress of Industrial Organizations, I welcome this opportunity to offer our strong support for the Public Company Accounting Oversight Board's proposed rules to promote the ethics and independence of outside auditors.

The AFL-CIO is the federation of America's labor unions, representing 60 national and international unions and their membership of more than 13 million working women and men. Union members participate in the capital markets as individual investors and through a variety of benefit plans with over \$6 trillion in assets. Union-sponsored pension plans account for \$400 billion of that amount.

The AFL-CIO and worker pension funds have actively sought to enhance auditor independence ever since Enron's collapse exposed major weaknesses in the existing auditor regulatory regime. The issue the PCAOB now seeks to address—the provision of aggressive tax services to audit clients—was at the very heart of the Enron scandal¹. It is inexcusable that, despite the reforms enacted in response to Enron and subsequent scandals, auditors are still permitted to provide tax services that place them in the role of advocate for their audit client or its executives, and requires them to audit their own work. We were especially disappointed that the final auditor independence rules adopted by Securities and Exchange Commission (the "Commission") in March 2003 failed to ban this practice, as the AFL-CIO and other investors had recommended.

We therefore commend the PCAOB for proposing rules that would put an end to the serious conflicts of interest that result when auditors provide aggressive tax services to an audit client or

¹ As reported in *Journal of Corporation Law*, "Arthur Andersen was both promoter and tax opinion provider (as well as external auditor) for Tanya and Valor, two of Enron's earliest tax shelters." (Beale, Linda M., "Putting SEC Heat on Audit Firms and Corporate Tax Shelters", *Journal of Corporation Law*, January 1, 2004.)

any tax service to the client's senior officers. These rules and the proposed rules prohibiting the sale of services to audit clients on a contingent fee basis will meaningfully strengthen the independence of outside auditors and thereby enhance investor confidence in the integrity of audited financial statements. We generally support the rules as proposed, and offer a few specific comments below.

I. Background

Independent auditors occupy a central position in promoting confidence in the integrity of the financial reporting system and U.S. capital markets. Because the Commission requires that financial information filed with it be certified or audited by independent auditors, auditors are, as the Commission has stated, the "gatekeepers" to the public securities markets.² Auditors work not only for their clients, but also for the investing public.

The role of Arthur Andersen in the fall 2001 collapse of Enron thrust the role of independent auditor into the spotlight, reopening a debate the Commission had sought to resolve with its 2000 rulemaking. In response, the AFL-CIO petitioned the Commission in December 2001 to further strengthen its rules governing auditor independence by, among other requirements, limiting the services accounting firms could provide to their audit clients.³ In December 2002, in response to our petition and the subsequent requirements of the Sarbanes-Oxley Act, the Commission proposed comprehensive rules to strengthen its auditor independence rules. The AFL-CIO supported the proposed rules, but recommended

the Commission modify its proposal to conform more closely to the recommendation in the recent report issued by the Conference Board Commission on Public Trust and Private Enterprise.⁴ That report concludes that there is no conflict of interest in a public accounting firm providing certain income tax and other services, such as preparing corporate tax returns, "provided that these services do not place the auditor in the role of acting as advocate for the company." Consistent with this finding, audit firms should not be permitted to advise companies on "debatable tax strategies and products that involve income tax shelters and extensive off-shore partnerships or affiliates."⁵

The fact that the Commission's final rules did not prohibit auditors from selling these aggressive tax services to clients was among the factors that prompted worker funds to seek to strengthen auditor independence beyond the Commission's requirements on a firm-by-firm basis. Worker

² Revision of the Securities and Exchange Commission's Auditor Independence Requirements, Exchange Act Release No. 43602 (Nov. 21, 2000) (adopting release).

³ Request for Rulemaking Concerning Definition of Independent Auditor and Limiting Services Accounting Firms May Provide to Audit Clients, submitted to the Securities and Exchange Commission by Richard L Trumka, Secretary-Treasurer, AFL-CIO, December 11, 2001.

⁴ Conference Board Commission on Public Trust and Private Enterprise: Findings and Recommendations, January 9, 2003.

⁵ AFL-CIO Comment Letter on Securities and Exchange Commission proposal, S7-49-02, to Strengthen the Commission's Requirements Regarding Auditor Independence, submitted by Damon Silvers, Associate General Counsel, AFL-CIO, January 13, 2003.

funds have subsequently sponsored shareholder resolutions at dozens of companies seeking to limit the non-audit services performed by the company's auditor and have also opposed auditor ratification at companies where the auditor's independence has been compromised. In May 2003, for example, the AFL-CIO led a block of Sprint shareholders that cast 38 percent of their votes against the ratification of Ernst & Young after we learned the audit firm had advised the Sprint's top executives on personal income tax avoidance strategies while simultaneously providing auditing services to Sprint.

We are therefore pleased that PCAOB is now proposing rules that would put an end to the serious conflicts that result when auditors provide aggressive tax services to an audit client or any tax service to the client's senior officers. These rules and the proposed rule prohibiting the sale of services to audit clients on a contingent fee basis will meaningfully strengthen the independence of outside auditors, an objective of fundamental importance to worker fund shareholders and to the capital markets as a whole.

II. Specific Comments on PCAOB Proposal

While we strongly support the proposed rules and believe they substantially implement key recommendations of the Conference Board Commission on Public Trust and Private Enterprise, we recommend the PCAOB consider several modifications.

First, with respect to Proposed Rule 3522 – Aggressive Tax Positions, we recommend the PCAOB also prohibit the provision of expatriate tax services since these non-audit services can generate significant fee income to the audit firm. Second, with respect to Proposed Rule 3523 – Tax Services for Senior Officers, we recommend the PCAOB (a) define the vice president of sales as a senior officer with a financial reporting oversight role, since improper revenue recognition is the leading cause of restated financial statements; and (b) expand its proposal to also include members of the audit committee of the board of directors, which is responsible for hiring and evaluating the outside auditor.

Finally, in addition to prohibiting aggressive tax services, contingent fee arrangements and the provision of tax services to senior officers and audit committee members, we encourage the PCAOB to also prohibit auditors from consulting on the compensation arrangements of company executives. While we believe it is appropriate for outside auditors to offer routine tax preparation services for organizations and individual managers, advocacy consulting on executive compensation is inappropriate. Although not a tax service per se, the nature of this conflict is similar to the conflict that arises from the provision of aggressive tax services. As we explained to the Commission in our second comment letter in response to the Commission's December 2002 proposal to strengthen the auditor independence rules,

By advising the board on executive compensation, an auditor is in effect evaluating the performance of that executive, a role that could make an auditor reluctant to draw attention to possible shortcomings by that executive in the future. Alternatively, if the auditor advises the executive on his or her compensation, the auditor is acting as an

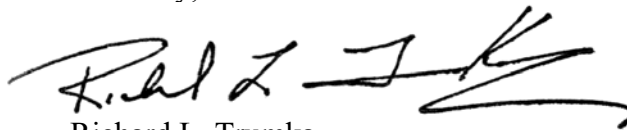
*advocate for the executive, a role that conflicts with the auditor's duty to shareholders. In either case, the auditor's independence is impaired.*⁶

Given the similar nature of this conflict, we believe it appropriate for the PCAOB to address it within its current rulemaking process.

III. Conclusion

We commend the PCAOB for formulating meaningful rules to promote the ethics and independence of registered public accounting firms, and we support their rapid adoption. We thank you for the opportunity to comment on this proposal, and hope that the PCAOB will consider our comments in formulating its final rules. If you have any comments regarding our comments, please feel free to contact Damon Silvers, Associate General Counsel, at (202) 637-3953.

Sincerely,

A handwritten signature in black ink, appearing to read "Richard L. Trumka", with a stylized flourish at the end.

Richard L. Trumka
Secretary-Treasurer

⁶ AFL-CIO Supplemental Comment Letter on Securities and Exchange Commission proposal, S7-49-02, to Strengthen the Commission's Requirements Regarding Auditor Independence, submitted by Richard L. Trumka, Secretary-Treasurer, AFL-CIO, January 21, 2003.