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Board Members:

These are my comments on PCAOB Release No. 2015-004, "Supplemental request for comment: Rules to require disclosure of certain audit participants on a new PCAOB form (Request)." This is a supplement to the Board's 2013 Reproposal to require auditors to disclose in the auditor's report the name of the engagement partner and information about certain other participants in the audit. In my January 6, 2014 letter to the Board I strongly disagreed with disclosure of the name of the engagement partner while agreeing, subject to some modifications, with listing the names, locations and extent of participation of other accounting firms and other persons that took part in the audit.

The Request focuses primarily on the question of whether the information being considered for disclosure should be included in a new form to be filed with the PCAOB rather than in the auditor's report. On page 2 the Request states that, "The Board continues to consider whether to mandate auditor disclosure regarding certain audit participants and, if so, whether disclosure should be made in the auditor's report or on Form AP." However, it also notes that "... investors have consistently sought (this disclosure) throughout the Board's rulemaking process ..." More importantly, the 27 page appendix on Economic Considerations reads, at least to this commenter, as a basis for concluding that these disclosures should be required. Thus, notwithstanding the "continues to consider" wording mentioned above, the Request reads as though the Board has decided that these disclosures will be mandated and the only question is whether they will be in the auditor's report or the new Form AP. The PCAOB has developed the Form AP approach to address concerns raised by accounting firms that including the engagement partner name in the auditor's report would lead to increased liability and perhaps greater litigation risk.

The SEC has also issued a concept release (Release), "Possible revisions to audit committee disclosures." Questions 34-42 of that Release ask whether disclosure of the name of the engagement partner would be useful to investors and, if so, where it should be presented. While I continue to believe that disclosure of the engagement partner's name is not useful to investors, if such disclosure is made it would be more logical to do so in the audit committee report in the proxy statement wherein investors are often asked to ratify audit firm selection. (Questions 48-49 in the Release also deal with the related matter of possible disclosure of other firms involved in the audit.)

The purpose of this letter, then, is to provide additional comments as to why I believe disclosure of the name of the engagement partner should not be required. While I plan to comment on this matter to the SEC, I'm hoping the PCAOB is still open minded and will consider further input. In particular, I believe it is appropriate to respond to some of the points made in the Economic Considerations section of the Request with which I do not agree. Also, I have read all of the comment letters from users on the 2013 Reproposal and wish to share a few observations about points made in some of those letters.

Economic Considerations

On page A2-8 under The Benefits of Disclosure, the Board argues that, "Among other things, the disclosures would allow investors to research whether engagement partners have been associated with adverse audit outcomes that could be attributed to deficiencies in their audit work or have been sanctioned by the PCAOB or SEC." As noted in my earlier letter, this notion of accentuating the negatives and using the naming process as a way of ferreting out bad actors seems to be a prominent theme if not the causal theme of the whole exercise. For example, on the following page the Request states, "For example, investors would be able to observe whether financial statements audited by the engagement partner have been restated or whether the engagement partner has been sanctioned by the PCAOB or SEC, and investors and other financial statement users could also research other publicly available information."

But the Economic Considerations section gives very little attention to exactly how this "research" or these "observations" by investors and other interested parties would occur. A name by itself is of very little value although some searching of SEC or PCAOB enforcement releases using only names might be possible. More likely, as the earlier Reproposal indicated, some sort of databases would need to develop over time to include not only engagement partner names but important related information. As Board Member Ferguson suggested at the June 30 PCAOB Open Meeting, "It seems likely that eventually information will be publicly available about engagement partners such as the companies they have audited, their industry experience, any disciplinary actions in which they have been involved and likely other information." Rather than such general speculation about whether such an information base would be developed and what it might include, I believe the PCAOB (and/or the investors who request the information) ought to have a better idea of what might be in such a database before mandating disclosure to feed into it. And who is going to develop the information and pay for its upkeep? Would investors really be willing to put their money where their mouth is on this?

I am reminded of "If you build it, they will come," from the movie *Field of Dreams*. But in that fictional setting there was a definitive building plan to produce the desired outcome. The Request fails to offer more than one of the pieces of construction material in hopes that others will pitch in with the remaining pieces and somehow produce a meaningful completed structure. Not a word is said about who will pay for those other pieces, as just one defect of the Request.

In thinking about the possible contents of such a database, several matters come to mind. It might be fairly easy to gather the information needed to post SEC and PCAOB enforcement actions. However, as I stated in my earlier letter, I suspect that nearly all audit committees would reject someone subject to an earlier enforcement action from becoming their engagement partner, assuming the individual is even allowed to continue to serve public clients. So the inclusion of any such individuals in a database should be of no real importance to investors. When Board members suggest that such future database would help investors "... identify whether an engagement partner has been the subject of any public disciplinary proceedings (statement of Board Member Harris at PCAOB Open Meeting on June 30)," have they considered that no conscientious audit committee would ever accept an engagement partner with such a blemish on their record?

Next is the issue of restated financial statements. Many restatements are greatly concerning and could certainly call into question the technical capabilities of the engagement partner. However, some others result from new interpretations from the SEC or other matters that do not have the same negative connotation. Treating them all as a "black mark" against the engagement partner would seem inappropriate. But who would determine whether some were acceptable and shouldn't be charged against the engagement partner? (See further comments about users' views on this matter later in the letter.)

Similarly, issuing a going concern opinion too late may be considered a negative but when was the "right time" for that qualification to be issued? Should all bankruptcies following unqualified audit opinions be considered negative factors in such a database? If not, who will be the arbiter for such judgments?

Another negative would be receiving a poor inspection report from the PCAOB. However, these reports are purposely not identified by company or individual and that would seemingly preclude their being included in an engagement partner names database. Further, even if some way were found to include this information some might question whether all reports for which exceptions are reported by the PCAOB would warrant inclusion in the database or whether some do not rise to the level of besmirching a partner's reputation in that manner.

While I'm concerned that emphasis is placed on negative factors in discussions about an engagement partner database, I'm equally concerned about what might be included as positive factors. Here are some of the things that came to mind that might possibly be included eventually in a database. While the Board doesn't need to specify the required contents of a future database, it ought to at least give some more details than it has suggested so far about what might be included to allow commenters to judge whether it's a useful notion and someone would actually pay for its use.

- The partner's education. What degrees and from where?
- All previous engagement partner experience. If all company names are not listed, should at least industry type be given?
- Recent professional development courses taken.
- Inspections of previous audits by the PCAOB for which no exceptions were reported (I assume there would be the same privacy concerns about reporting this positive information as about the negative inspections information mentioned above.)

In addition to being concerned about how engagement partner information would be used, I continue to be dismayed by the Request's various assertions about greater "accountability" supposedly flowing from being named publicly. For example, "The new disclosures should also increase accountability for auditors who are not operating at an appropriate level of accountability, because they would now be publicly associated with the audit (page A2-9)." And, "The public nature of this information, through which audit outcomes would be publicly associated with the engagement partners and other firms involved, should provide them with additional incentives to develop a reputation for consistently performing reliable audits (page A2-13)." I was particularly chagrined when I read on page A2-14 that the Board believes that "... some (engagement partners and other firms participating in the audit) already operate with a high sense of accountability." My online dictionary includes "certain" and "several" as synonyms for "some" and I certainly hope that this was a poor choice of words in drafting rather than what Board members really believe is the state of current practice.

As I said in my earlier letter, in my experience as both a public accounting firm partner and an audit committee chairman, I believe that engagement partners take their job extremely seriously. When they sign off on the firm's review and approval checklist to authorize issuance of the audit report, they recognize the great responsibility they are assuming – to investors, to the public, to the client, and to their firm. They are scared straight these days by the possibility of a PCAOB inspection that could result in serious damage to their career should inspectors find fault with their work. In addition to the quality review already performed by an independent partner, they realize that their work is further subject to challenge by the SEC should the Division of Corporation Finance or others at the Commission review the registrant. And if not reviewed by the PCAOB, their work will be subject to the firm's internal quality review program. Finally, civil litigation that threatens the very existence of accounting firms always lurks in the background as a factor that sharpens the attention of engagement partners.

The Economic Considerations section of the Request refers to some academic studies but acknowledges that none of these studies directly address the accountability issue. In short, this continues to represent a matter on which the Board asserts improvement in audit quality without any real evidence in support. On the other hand, the factors I have listed concerning substantive factors influencing engagement partner performance would indicate that as a group they are performing about as well as can be expected and being named in any public report could not result in measurable improvement. As evidenced by the PCAOB inspection process and otherwise, there is no question that technical performance by individual partners varies. But that is due to normal human differences and not to a lack of commitment or sense of responsibility by some. Nevertheless, the notion that disclosing the name of the engagement partner leads to

"greater accountability" and higher audit quality means that the Board believes that many engagement partners are not sufficiently accountable at present.

It would be interesting to hear more from the Board (and users) as to the implications of such a belief. For example, does the Board believe (and have evidence to support) that we presently are faced with a situation where most engagement partners are fully accountable but we just need to raise the level of accountability of the remainder? If so, how large does the Board believe is that remainder? Instead, does the Board believe that nearly all engagement partners are quite accountable (say at the 95% level) but if their name were made public they would be even a little more accountable and get close to 100%? Or given the "some" language quoted above, does the Board believe that most engagement partners are not really very accountable (perhaps operating at the 75% level, on average) and naming them will increase audit quality very substantially? I know it isn't easy to reduce "accountability" to a specific percentage, but I also think the Board owes its publics a better explanation of what it really expects when it suggests that naming the engagement partner will lead to more accountability and higher audit quality.

The main purpose of the Economic Considerations section of the Request is, of course, to address the Board's responsibilities to weigh the potential benefits and costs of new standards including their economic impacts. However, in my view the Economic Considerations section does not persuasively demonstrate that the project would result in information in a form that would provide decision useful information to investors. And the Economic Considerations section does not contemplate all of the obvious added costs to the financial reporting system. This section of the Request is longer than the similar section from the Reproposal but it isn't necessarily better or more persuasive.

One of the added costs, in my view, is that with such a negative emphasis on the engagement partner disclosures, there would be a natural reaction by audit committees to reject any engagement partner candidate with the slightest blemish on her/his record. Thus, it would be "one strike and you're out" for anyone who is unfortunate enough to be involved with a restatement, a going concern opinion, accounting-related litigation, negative PCAOB inspection results, and possibly other factors. While some might argue that this is exactly what the PCAOB is trying to accomplish – drive higher quality by removing poor performers from the talent pool – it would have the effect of reducing the pool of those available to perform public audits. That reduction of qualified individuals would almost certainly increase audit costs and would likely increase overall audit risk. And, as I said in my earlier letter, the threat of this occurring is likely to cause many highly qualified audit partners to leave public accounting as well.

Granted, a perfect, before-the-fact cost/benefit analysis of a proposal rule such as the one under consideration is virtually impossible. But I believe the Economic Considerations section of the Request falls short of what the Board could and should do before adopting a final rule in this area. The Economic Considerations section consists mainly of the Board's own reasoning as to why disclosure should be made, supported by several academic studies, most of which are not directly on point and include little, if any, attention given to cost/benefit analysis.

Perhaps a better approach to studying costs and benefits would be for the PCAOB to sponsor a field test of its proposal. This has been done successfully by the FASB on several occasions and has often led to significant insights about proposals before their finalization.

Such a field test could involve working with a group of accounting firms and investor representatives to discuss what factors about engagement partners might be gathered, such as some of those mentioned earlier. This would provide an opportunity for the two sides to exchange views about the ease of developing that information, how long it would take to develop, how it might be used, etc.

Another step in the test would involve discussing with the investor representatives or others how such a database would be developed and exactly how information developed would actually be used in making investment decisions. This would include thinking through issues such as:

- Would any entity be motivated to develop such a database as an entrepreneurial project or would it require advance funding?
- Assuming the project would require advance funding (I think it probably would), would the investor representatives be willing to pay for it? How much?
- Given that it would probably take at least five years or so for there to be enough meaningful information in the database, would users be willing to wait that long and pay for it during a long ramp up period?
- Exactly how would the investors use the information in the database? The Request and comment letters suggest some possible uses but a field test might force users to refine their thinking and decide whether such a new database is really worthwhile – particularly if they have to pay for it!

These are just a few suggestions. A robust field test could easily be performed in the next few months that would provide the Board with more meaningful input than the largely speculative thinking in the present Economic Considerations.

Users' Comment Letters

In response to the Reproposal, the Board received comment letters from the following individuals or organizations that I would classify as users.

- Sinclair Capital LLC
- CFA Institute
- Fund Democracy/Consumer Federation of America
- State of Connecticut
- American Federation of Labor and Congress of Industrial Organizations (AFL/CIO)
- Council of Institutional Investors
- California Public Employees' Retirement System (CalPERS)

As the Board stated in the Request, all of these users support disclosing the name of the engagement partner. Their letters make the same two points mentioned above: better information for investors and greater accountability by auditors leading to higher audit quality. As stated by

Denise Nappier, Connecticut State Treasurer, "The measures proposed in the Release will provide investors with valuable information and foster greater professional accountability on the part of auditors, thereby improving audit quality."

However, some of the letters paint an incomplete picture of that earlier proposal. For example, the AFL/CIO, states, "With the proposed disclosures, shareholders will be better able to evaluate whether engagement partners and any third parties participating in the audit have a history of financial restatements, disciplinary hearings or litigation." That, of course, is incorrect as disclosing a name by itself has no context and requires development of the database mentioned above. Sinclair Capital alludes to this in its letter by saying, "It would be nice for investors to be able to look at the new engagement partner and note that he/she has a great deal of expertise in technology or automotive or finance or whatever the main business is of the issuer." Sinclair at least implies that the name by itself means little; information about the person is what those investors are seeking.

But notably missing from those letters is any mention of how the information about engagement partners would be collected and financed. The letters do provide some examples of the type of information about engagement partners that might be gathered but even that should be challenged. For example, the AFL/CIO letter refers to restatements as does the CalPERS letter. But that latter letter includes the following statement, "For example, if an issuer restates its earnings, financial statement users, corporate boards and firms themselves may take note of the audit team personnel and may request another audit partner or personnel be assigned to the audit going-forward." But that is an oversimplification as the restatement might relate to financial statements audited by a predecessor engagement partner. Or, as mentioned earlier, not all restatements are created equal and a snap judgment to replace the engagement partner just doesn't seem to be logical.

It is, of course, true that users continue to believe that greater accountability will ensue from naming the engagement partner. For example, Sinclair Capital states, "... personally (sic) identification should have a salutary effect on the care with which the engagement partner conducts the audit." And Fund Democracy/Consumer Federation of America says, "We strongly agree that naming the engagement partner will improve audit by incentivizing the partner to exercise greater diligence and more forceful leadership."

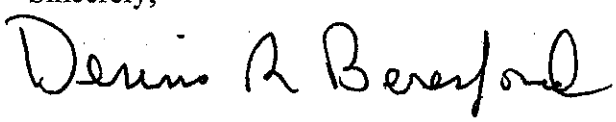
CalPERS may have inadvertently provided an excellent insight about "accountability" in their comments about other participants' involvement in the audit process. Their letter states in response to three different questions in the Reproposal that, "We believe greater accountability will be achieved through the specific identification of everyone substantially contributing to the performance of the audit." While I know the reference to "everyone" in the CalPERS letter was intended to encompass other firms involved in the audit, it could easily be read to mean the quality review partner as well as any other partner who is required to rotate as well as those specialists assigned to the engagement. To effectively respond to these users' needs, therefore, the PCOAB should call for naming all of the key partners engaged in the audit and not just the one individual. An audit is not a "one woman/man job" – it is a team effort and naming a single person sends the wrong message to investors.

In summary, the views of users seem to suffer from the same weaknesses as the Board's arguments. They believe disclosure of the name of the engagement partner would somehow provide more useful information to investors but they fail to state what a necessary information base would include. And they say nothing about who would finance its development. With respect to "accountability," they argue it would be improved with disclosure of the engagement partner name. But exactly why that would occur as compared to all of the safeguards presently in place is absent from their letters. And, similar to the PCAOB, they fail to articulate any conception of the measurable improvement that somehow would occur in engagement partner performance and resulting audit quality.

Conclusion

I plan to comment on the SEC Release and indicate, as in this letter, that a persuasive case has not yet been made to require disclosure of the name of the audit partner – certainly at least not until matters discussed in this letter are addressed. I do believe that this entire project more properly belongs on the agenda of the SEC as the project has little to do with audit quality and it should be the SEC that determines whether investors would find the information useful in making proxy voting decisions and otherwise.

Sincerely,



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