Dennis R. Beresford
Executive in Residence
J.M. Tull School of Accounting
Terry College of Business
The University of Georgia
Athens, Georgia 30602-6252
706 542-3502

January 6, 2014

Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington, DC 20006-2803

Rulemaking Docket No. 029

Board Members:

These are my comments on PCAOB 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." In summary, the Exposure Draft (ED) would require disclosure in the auditor's report of (1) the name of the engagement partner, and (2) names, locations and extent of participation of other accounting firms and other persons that took part in the audit. My comments are derived primarily from perspectives gained from serving as chairman of the audit committee for five large public companies over the past twelve years, but also from my earlier 26 years in public accounting audit practice serving many SEC registrants.

In summary, I do not support naming the engagement partner in the auditor's report. It is not meaningful information to users; the forthcoming work on Audit Quality Indicators promises to produce more useful data. Further, the notion that naming the engagement partner will somehow increase his/her accountability is simply wrong. I do support the disclosure of "other parties" although I believe the disclosure needs to be supplemented in order to clarify the signing firm's oversight responsibilities. Otherwise, it could be more confusing than informative, particularly when the "other parties" share a common name with the signing firm.

My reasoning for these positions is presented in the following two major sections of this letter.

Naming the Engagement Partner

What is the real objective of naming the engagement partner and will it be achieved? - As noted in the description of the ED, the Board believes that naming the engagement partner in the auditor's report will "improve the transparency of audits." The Introduction goes on to say that the Board believes this information "would be useful to investors and other financial statement users and would be consistent with the Board's mission to further the public interest in the preparation of 'informative, accurate, and independent audit reports.'" The Release describes ways in which service providers might begin to gather information on engagement partners in the future that investors and other users could find helpful. Enhanced user information appears to be the principal reasoning for the Board's conclusion that the engagement partner's name should be required. In the words of Board member Jeanette M. Franzel, "Today's release states that the primary benefits of the current proposal pertain to disclosure, or transparency."

However, on page 5 the ED states, "The Board also recognizes that many investors as well as some other commenters 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." Again quoting Ms. Franzel, "The release also suggests that such disclosure may create an incentive for auditors to voluntarily take steps that could result in improved audit quality." Later she notes, "Today's release does not explain why the Board has changed its objectives for the reproposal from accountability to disclosure of useful information for investment decisions (as names are collected over time and combined with other unspecified information). And, with those changed objectives, the Board is now in a position to surmise how, or hope that, such information may be compiled and made useful over time."

This change in objective is even more troubling given concerns raised at an earlier date by then Board member Dan Goelzer regarding the appropriate role of the PCAOB. He questioned whether naming the engagement partner was more of an SEC proxy disclosure issue than a PCAOB auditing matter. In his statement at the meeting at which the earlier ED was adopted, Mr. Goelzer stated, "The partner's name may be relevant to the shareholder vote on selection of the auditor. However, the disclosure requirements of the federal securities laws, including the proxy rules, are administered by the Securities and Exchange Commission. Unless

engagement partner disclosure can be directly linked to improving audit quality, or to promoting understanding of the financial statement audit or of the Board's inspection program, the issue would seem to fall in the SEC's bailiwick."

Chairman Doty appeared not to emphasize a single objective for naming the engagement partner in his remarks at the AICPA National Conference on SEC and PCAOB Developments on December 9, 2013. While he began his comments on "audit transparency" by stating that "Investors have long asked for the names of engagement partners to be disclosed, in order to give them more information about the auditor," the rest of his comments on that topic focused largely on the "quality improvement" objective. For example, "... it holds the promise of improving audit quality by sharpening the mind and reminding auditors of their responsibility to the public." And, "In many fields, disclosure – Justice Louis Brandeis called it 'sunlight' – has given numerous fields and professions the information they need to see and then remedy a problem."

I believe an astute assessment of the purpose of disclosing the name of the engagement partner was contained in the comment letter on the earlier ED of Professor James L. Fuehrmeyer, Jr. of the University of Notre Dame. Professor Fuehrmeyer, a former senior audit partner with Deloitte & Touche, included the following excellent analysis in his comment letter dated December 13, 2011, which I believe applies just as much to the current ED:

> The Proposed Amendments appear to reflect the notion that the investment community should grade the audit in the same way rating agencies grade securities. The Board should not expect individual investors to grade auditors. We already have a process in place to evaluate auditors and audit firms and that process falls directly under the responsibility of the registrant's audit committee. That committee is directly charged under the Sarbanes-Oxley Act with responsibility for "the appointment, compensation and oversight of the work of any registered public accounting firm employed by that issuer..." Audit committees are charged with evaluating and selecting auditors. The Proposed Amendments would undermine that process.
>
> The Proposed Amendments place too much emphasis on the role of one individual. Audits are conducted by teams of individuals; the largest audits have numerous partners, managers and staff comprising the audit team. While the signing partner has overall responsibility and signs the opinion on

behalf of the firm, it's not an individual project with technical support. In many cases that lead partner is not the only key player in the conduct of the audit. For example, a partner supervising the audit of a major corporation with highly material exposure for asbestos related claims or supervising the audit of an insurance company would rely extensively on the work of the actuarial specialists who are part of those audit teams. The lead partner on the audit of a financial institution engaged in loan originations and securitizations would depend on the work of financial instrument specialists in the valuation of individual deals. Lead partners must rely on specialists in many areas including business valuation, international taxation, management information systems, government contracting, medical claims evaluation, appraisal of real estate, translation from other languages into English, computer system security, engineering and a host of others. Many engagements use multiple specialists and no one on the Board would expect the lead partner to be a specialist in all areas. Evaluation of the quality of the firm's performance as the auditor includes evaluation of its capabilities in all of the many areas of specialization that pertain to the registrant's business. That evaluation is not captured in the disclosure of a single name or in the disclosure of the countries of origin of offices participating in the conduct of the audit. However, all of that information and more is routinely considered by audit committees as they fulfill their responsibility to oversee the independent auditor.

I fully agree with Professor Feuhrmeyer's analysis and his point was reinforced by a January 9, 2012 letter from The Center for Capital Market Competitiveness on the earlier ED. Rather than improving audit quality, which is at least a secondary (if not implicit primary) objective for this new disclosure, the Center believed the disclosure could have the opposite effect. "It is also problematic that the PCAOB continues to move in the direction of expecting engagement partners to somehow build their own individual reputations for audit quality, independent of their firm's reputation, undermining accountability in the audit process and harming investor protection."

The PCAOB suggests that naming the engagement partner could provide valuable information to investors as third parties collect that information over time and collate it with information on restatements, going concern opinion modifications, enforcement actions, and individual-specific data such as education, awards, publications, etc. One question that might be asked is if that is such a great idea, why isn't it being done now? For many years the identity of the engagement partner has been known by his or her appearance at the company's annual

shareholders meeting. If gathering and analyzing these relationships were truly useful to investors, in today's information age some enterprising businessperson probably should have already started gathering the data. Granted, it would be a lot easier to do so should the names simply be listed in the auditor's report but there won't really be any new information provided.

In thinking about how these data might be gathered and used, I urge the Board to consider the following. At least for the largest accounting firms serving public companies with the greatest market capitalizations in which there is the most investor interest, it would be unusual for an individual to become an audit partner before his or her early 30's. And it probably would be unusual for such a person to immediately become an engagement partner upon being admitted to the partnership, at least for a client that has a large market capitalization. And given an approximate age 60 retirement date for these individuals, they would likely have only approximately five "rotation opportunities." Of course, it is quite possible that many of them could serve more than one public audit client at the same time but those clients would generally then be smaller and of less investor interest. And the last rotation would be of no information consequence as the partner would retire after completing service on that engagement.

Thus, the data being gathered could reflect service on a relatively small number of clients for each partner over a twenty-year period – a fairly limited data base on which to draw any meaningful conclusions. Assuming none of the "negative factors" mentioned in the ED are present (see discussion below), there might be little information of consequence gathered about such individuals that would be of relevance to investors, except, perhaps, information about previous service for very specialized industry clients.

Rather than supposing that data gatherers would begin to accumulate this information over time and that it might be meaningful, wouldn't it make sense to first ask some of the accounting firms to do a little "field testing" to see how much information could be accumulated for a sample of partners? (Perhaps the PCAOB already has that information in its own records and could do so – I'm not familiar with the Board's records on engagement partners, etc.) If some data could be produced from such an experiment, it might then be shown to the users who claim they would find this to be meaningful in their investment decisions and they could be asked how it would actually be used.

Would audit committees find this information useful? – In addition to stating that some users have called for disclosure of the name of the engagement partner, the

PCAOB seems to think that some audit committee members would find this new disclosure useful. For example, on page 8 of the ED the Board states in its discussion of the comment letters on the earlier ED, "Others, such as some audit committee members and corporate officials, as well as an association of European auditors, shared the investors' views and expressed the view that naming the engagement partner in the auditor's report would be beneficial (my emphasis)." This led me to review the comment letters on the 2011 Release.

I found only two comment letters from individuals who identified themselves as having been audit committee chairs.

> Letter No. 11 from Mr. Jack Henry stated in part: "Your proposals for mandatory rotation and identification of the signing partner both strike me as solutions looking for a problem to solve. Neither proposal appears to be based on empirical evidence that the current state is broken and would be improved by either proposal." His letter goes on to state, "Identifying a signing partner is contrary to the way audits are performed. They are done by teams and the teams include more than a single partner. Major decisions are made by national offices, not signing partners." Mr. Henry noted that he had been with Arthur Andersen for 34 years before retiring from that firm.
>
> Letter No. 41 from Mr. Gilbert F. Viets stated in part, "My own experience as an auditor, board member, audit committee chair and meager investor suggests that disclosure of personal names of audit partners or staff is not necessary and ranks far down the list of things that will help solve problems we have had this past decade in getting correct financial statements. Many express a similar view. However, I see no harm in the proposal and looked (sic) forward to the responses of others."

Frankly, it is disappointing that so few audit committee representatives commented on the earlier Release, and that motivated me to do so this time. But I find it very difficult to understand how the Board can represent that "some" audit committee members agreed that disclosing the name of the engagement partner would be beneficial based on the comment letters received on the earlier ED. Frankly, in the spirit of auditor skepticism, I would have expected Board members to have challenged and more carefully fact-checked such a counter-intuitive statement in the current ED.

In his remarks to the AICPA conference, Chairman Doty also suggested that audit committees would be direct beneficiaries of the new engagement partner information as it is gathered and analyzed over time:

> Nor can the responsibility to select only the best engagement partner be placed at the feet of audit committees, unless we provide audit committees better information against which to benchmark. Diligent audit committees try to obtain information about, and pay careful attention to, a proposed engagement partner's history. But today most of that information must come from the very firm putting the partner forward. The lack of generally available information about engagement partners limits audit committees' ability to meaningfully assess and compare the partner's qualifications and experience.

I respectfully disagree with Chairman Doty. Based on my experience and discussions with scores, if not hundreds, of other audit committee chairs and members through various seminars and other meetings over the past few years, no one has suggested the need for public information in order to meaningfully assess qualifications and experience. In fact, it is just the opposite. We are able to dig deeply into the individuals' background and experience through confidential sources rather than relying on the type of limited public information that would be gathered under the PCAOB proposal and would often be out of date. Further, depending on the size and the nature of the engagement, there is usually more than one candidate for engagement partner rotation, and they are subject to in-depth interviews on a subjective basis. Also, it has become a general "best practice" to inquire of the audit committee chairs and CFOs with whom candidates previously worked to learn about past performance. This would include important matters such as:

- Did the partner inform management and the audit committee about accounting and auditing issues that arose on a timely basis rather than possibly allowing them to worsen into larger issues because of a failure to communicate promptly?
- Did the partner have an effective relationship with the audit committee chair that made clear the firm's reporting relationship was to the committee and not to management?
- Was the partner successful in building good rapport and trust with all members of the audit committee and not just the chairman?

As an example, for one of my previous audit committee engagement partner rotation decisions, let me briefly describe some of our process. After reviewing resumes of several potential candidates identified by the firm, we selected three finalists for in-depth interviews by the audit committee and management. After initial interviews, one candidate was eliminated and our final decision came down to a choice between two individuals who the audit committee considered very well qualified. One candidate had more international experience, which was a plus. One had previously not served as an engagement partner on such a major audit but had been an assisting partner on an even larger audit – the other was rotating off being engagement partner on a major account. One was a female and one was a male, and our end customers were largely females. Neither had experience exactly the same as our industry, but our business was sufficiently general so that wasn't considered to be a problem. One had more national office contacts through service on firm committees, thus giving us more comfort that we would receive prompt assistance at that level when needed. Both individuals were well known to and were considered excellent by our outgoing engagement partner, with whom we had developed a high degree of trust.

The point of the above is simply that our final decision was a thoughtful judgment after weighing all of the competing factors (I listed only a few). That is a significant responsibility assigned to audit committees under the Sarbanes-Oxley Act and it is taken very seriously. Most of the types of information mentioned above (as well as the type of information from interviews with other audit committees served) could never be captured in a public disclosure system. At best, disclosing the name of the engagement partner and accumulating some related information over time will only be piecemeal and perhaps even misleading.

My experience has been primarily with quite large public companies and it may well be the case that naming the audit partner could be more useful for audit committees of smaller public companies. However, if they are served by smaller accounting firms, they will have much less choice among engagement partners in the first place so having the information made public wouldn't be meaningful to audit committees of those companies either. In short, I don't agree with Chairman Doty's remarks on this matter and believe the Board should challenge the assertion before accepting it as a possible reason for adopting a final rule.

<u>AQI – A more promising approach</u> - The PCAOB's Audit Quality Indicators project, while in an early stage, shows great promise of providing meaningful information to investors and other users of audited financial statements about the quality of audits. Naming the engagement partner is at best a premature and small

part of the AQI package, and more likely not a meaningful indicator at all. I support the Board's efforts to develop useful AQI's and look forward to the forthcoming Concepts Release as the first public step in that process.

The proposal accentuates the negatives - I'm very concerned about the overly negative emphasis in the matters that the Board suggests might be gathered and disclosed about a named engagement partner. The types of matters related to the engagement partner that the Board thinks might be gathered in the future include association with restatements, going concern modifications, and enforcement actions – all quite negative matters. While some of the suggested personal information, such as previous industry experience and "awards," are more positive, overall this seems to be an exercise to ferret out bad actors rather than identifying high quality performers. As noted below, I have reservations about each of the "negative indicators" suggested in the ED as to how they would be implemented in practice and whether they would, in fact, be meaningful to investors and other potential users of the information. I also am concerned that emphasizing the negatives could just add to the stress faced by so many audit partners in today's world who already may feel that PCAOB inspectors are the enemy and are "out to get them." I hear quite often about this unnecessarily adversarial attitude and the reality that many, well qualified individuals are being driven out of audit practice by what they perceive as a "gotcha" mentality of the inspections staff.

The Release suggests looking for association with restatements but which partner really has the principal responsibility? The one who signed the report when an error was first made? The one who signed the report when it was corrected? What if the correction was a change in understanding of the application of an accounting standard such as occurred for certain lease accounting issues several years ago that occasioned a couple of hundred restatements? There are so many questions involved here that users would almost have to have an FASB or SEC rule to know how to judge whether a restatement was or was not a black mark on an engagement partner's record.

And the Release seems to equate a going concern modification with negative performance by the engagement partner. To the contrary, standing up to the client and insisting on such a position often takes great courage as it can have extremely damaging consequences to a company. This may actually be a positive rather than a black mark!

As for involvement with PCAOB or SEC enforcement actions, I am reasonably confident that accounting firms withdraw the offending partners from active

management of public audit engagements in most if not all cases, certainly for those with a significant market capitalization. In any event, it is impossible for me to imagine that an audit committee would accept a new engagement partner with such a blemish on his or her record. Thus, I don't see the need for further user information or public protection beyond what is presently available with respect to enforcement matters.

Greater accountability? Not! - As noted by Ms. Franzel, "The release also suggests that such disclosure may create an incentive for auditors to voluntarily take steps that could result in improved audit quality." Board member Steve Harris stated, "Investors and others have asserted that disclosure of the engagement partner's name will produce a heightened sense of accountability for the audit on his or her part, which will lead to more robust audit behavior and higher quality audits. This is not surprising, given that personal accountability is a foundation of performance in all walks of life." However, Board member Jay D. Hanson, who has actually "been there, done that," accurately observes, "Accountability for audit engagement partners, in my experience, is already built into the system." Mr. Hanson also noted that the Board had found no evidence that identifying audit partners will enhance the accountability of those partners and therefore enhance audit quality.

I fully agree with Mr. Hanson based both on my own auditing experience with a major accounting firm and in dealing with engagement partners with most of the largest accounting firms in my capacity as an audit committee chairman over the past twelve years. It is most disrespectful to engagement partners to suggest that they will somehow heighten their sense of accountability when named in the accountant's report. Now, they sign their name in the firm's review and approval forms in order to issue the auditor's report, which is the point at which they accept full responsibility for that report. They also realize they are subject to inspection by the PCAOB and their career is at stake should the inspections team find serious fault with the work on their audit. And, of course, their various judgments and other audit work are all subject to the firm's independent quality review, SEC review, civil litigation, etc. Further, they are continually challenged to do their best work by the audit committee. To suggest that somehow there is another level of quality to which they can rise as a result of being named in the auditor's report is both naïve and almost insulting, in my opinion.

A modest suggestion – As noted earlier, I suggest that the Board give a lot more consideration as to how the engagement partner name might be gathered and analyzed. If Board members can't think through what would be a reasonable way in which these data would be used, it isn't appropriate to start forcing firms to

begin disclosing the information. Working with accounting firms to gather what a sample of engagement partners would actually have had reported about them would be a good place to start in working toward whether this could be meaningful information.

Disclosing Certain Other Participants

I am in general agreement with the proposed disclosure of other participants in the auditor's report. And I support the changes to the earlier ED with respect to the minimum 5% cutoff for disclosure and the use of approximate percentage ranges. The ranges the Board has chosen seem appropriate.

I am, however, concerned about how investors will interpret disclosure of the fact that entities that are part of the global network of one of the major accounting firms are performing part of the audit. For example, without getting into confidential information, one of my former board companies was audited by Deloitte & Touche LLP in the United States. That firm, of course, was inspected by the PCAOB. But the company in question had extensive operations in Europe, Asia, Latin America, and Canada. In fact, approximately 50% of its revenues were from international sources. Deloitte performed statutory audits for most of the foreign locations and a material portion of them were included in the financial statements audit.

Using the example language beginning on page A2-6 of the ED, disclosure of that situation might be included in an Appendix along these lines (these countries and percentages are just made up by me for illustration purposes):

> 5% to 10%:
>
> - Deloitte & Touche LLP (United Kingdom)
> - Deloitte & Touche LLP (Hong Kong)
>
> Other participants whose individual aggregate extent of participation was less than 5% - fourteen other firms (should we say these were all Deloitte firms?) whose individual extent of participation was less than 5% of the total audit hours, participated in the audit.

While it is possible that users can be educated as to the meaning of this disclosure over time, at least initially I think many will be confused rather than informed by a Deloitte report that says that Deloitte performed part of the audit! This, of course, is important to know if one is interested to check on the (material) parts of the overall audit that weren't subject to inspection by the PCAOB. But it's the audit

committee that is the first line of defense on this matter and that committee will have reviewed the accounting firm's internal quality-control procedures, any material issues raised by the most recent internal quality-control or peer review, or any investigations of the firm. That committee will also have asked other, appropriate questions to be satisfied that the audit performed in all locations is of uniform quality.

I believe a disclosure along the lines of the sample I've suggested above needs to be supplemented with some language in the auditor's report to eliminate the possibility of a reader assuming that the "other participants" named in the report are of significantly lower quality. This could be done with wording that covers the signing firm's oversight, supervision, and review responsibilities over the other firms (including whether the other firms have been subject to the signing firm's inspection program). Perhaps the audit committee will also feel obliged to say something in the future in its report to indicate its satisfaction with the quality control procedures applied by the signing firm.

I can understand why the disclosure of other participants may be even more obvious and important in situations where a global alliance (e.g., "CPA Firms R us Worldwide") includes fully locally-owned and operated under different named firms. However, even there I would assume that further disclosure along the lines of what quality control procedures the signing firm has applied would be appropriate.

To be clear, while I generally support the proposed disclosure of other firms involved in the audit, I believe that absent accompanying explanations of the signing firm's oversight, etc., this disclosure would be so incomplete that it should not be included in the auditor's report. In that case, perhaps a discussion of the matter could be included in the audit committee report in the proxy statement or in material in the proxy statement related to a shareholder vote on auditor ratification.

With respect to the requirement for disclosure of Persons Not Employed by the Auditor, I understand the general reasoning for not naming all of the individuals or firms so included. However, it seems to me that if the percentage of the total hours performed by an individual is material to the overall audit, the reader should receive further information. I would assume that would be an unusual circumstance (perhaps it would never happen!) but if more than 5% of the total hours were performed by one of these individuals, I would suggest they should be identified by name and the nature of their services be stated.

I would be pleased to discuss any of the matters in this letter with you at your request.

Sincerely,

Dennis R. Beresford
Executive in Residence