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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

Members of the Board:

Thank you for this opportunity to respond. This letter summarizes my views on Docket Matter 029 and for your consideration I offer an additional observation in the **CONCLUSION AND SUMMARY**. You are far down the road on this proposal, but I hope these comments are helpful.

The proposal to disclose names of partners relies on the power of pride and personal reputation to move partners to a higher level of audit effectiveness. For others whose identity will be disclosed, the proposal provides names of parties who assist in audits, relationships now normally available only through litigation and media coverage of failed audits.

It is not unreasonable to believe that a partner and other participants will, on average, take their involvement more seriously and do a better job if their names are published.

Ideally, investors will learn more about auditors and others who contribute to audit conclusions, and, subsequently, investors make more sound decisions when they vote to ratify selection of the audit firm.

If it works, the proposal brings auditors, investors, and other parties contributing to the audit, closer to common objectives. It can help produce a fundamentally different relationship than now perceived to exist among all parties interested in audit outcomes.

The anticipated new relationship can have two very significant impacts:

1) The relationship can counter a long existing psychosomatic affiliation between management and auditors that aligns their interests. The closeness of the two is promoted by reliance on each other for sustaining their commercial bond, resting on who writes the checks, frequency of

contact opportunity, career evolution and many others, even as teammates in securities litigation, pursuit of protected legal environment and resolution of conflicts of interest.

2) The new relationship can also jar individual auditors out of mindset that what they do is somebody else's problem. This tendency results cumulatively from the socialization of errors within large partnerships, the multidisciplinary objectives of accounting firms, the limited liability financial structure of partnerships and confidential settlement of litigation rather than defense of positions.

Since the year 2000 there have been disturbing discoveries of financial reporting issues, many of which had grown unseen for extended periods, surprises undiscovered by external audits. The issues continued after the Sarbanes-Oxley and some would say the surprises are even more severe and threatening to the general economy. Also, the work of the Public Company Accounting Oversight Board in its reviews shows high rates of failure to support audit opinions issued.

However, solutions based on changing human nature usually have disappointing results. This proposal is little more than a plea for all to do a better job-- the "I'm going to tell your Mother!" threat. Arguing against it does not suggest approval of status quo, only disappointment in the mismatch of solution with the problem. Evidence is weak that this solution successfully matches the problem, even evidence that the problem is defined appropriately

The proposal is somewhat like campaigns in the 1950's and 1960's for drivers to be more careful as a means to reduce traffic deaths; but, deaths continued to climb. Trauma from heads and chests hitting something hard is a direct cause of death; driver behavior is an indirect cause but only in some accidents. Only later did someone decide seat belts would work. Traffic deaths rates per 100,000 drivers have been reduced by 2/3s after the first seat belt law was passed.

This proposal is not the "seat belt "solution. This proposal is a small tentative step which will be costly; even then, it will completely fail unless accompanied by other developments, some of which are identified in the proposal document.

DATABASES

Names of partners and other participants are useful only when they can be tied to events, trends or other indicators of reasonable expectations about future performance.

The **first big step required** is the development of meaningful, reliable data that fairly and completely present facts about audit partners and other participants. Such databases do not exist today and there are many impediments.

Information upon which the hopes of this proposal rest is processed slowly through a fine filter. PCAOB reviews, State Board of Accountancy disciplinary proceedings, confidential securities litigation and even settlements and criminal investigations all can take years; and these years of delay often occur after

years of undiscovered misbehavior. Resolution of each can result in complete concealment of the names, data then unavailable to the databases.

Today, the PCAOB agrees to treat the names of firm partners as confidential information. Even for those incidents where the PCAOB determines opinions issued are not supported by the audit work, the names of the audit partners and other participants are withheld; even identity of the company not properly audited is withheld.

Perhaps **the most helpful information would be about those financial statements which would have been wrong except for the principled audit partner who prevented the error**; no one records or reports this statistic; it is unavailable.

Among the major firms, there are probably five thousand partners authorized to sign audit reports, and the annual turnover rate among them is probably at least ten percent. Hopefully, the turnover is weighted toward those who prove to be problems. The database providers must continuously find information on several thousand churning people for which much of the most critical data, for this proposal, is unavailable or delayed for years.

The proposal is unclear about who is responsible for the databases and who will pay for them. The database developers must determine what information, sources, common measurements, distribution, quality controls, maintenance, storage and many other basic issues. No doubt, databases can be developed, but the challenge will be the quality of information and its currency. But when it is available, it will **be a source for tens of millions of investors to know and judge audit partners, even though only one of three can name their Congressional representative, and probably fewer the names of the CEO and CFO** of companies in whom they invest. This is not a criticism of investors, only a practical observation.

COST

The proposal will cost. Professional fees will be paid to accountants and lawyers for compliance with rules and review of wording for disclosure and consents. The cost will be higher in the first year, spikes for years when changes are made in the audit firm or partner and smaller for the routine recurring status quo years. Partners must rotate every five years so spikes are built-in. Similar costs will be incurred by other parties who participate in the audit. Costs will be larger for big companies than for small. I doubt the availability of empirical evidence of these costs that you seek.

My guess is that the annual cost for public entities will be aggregate less than $500 million per year. This guess is based on what is reported to be the average audit fee for public companies in the U. S. by FEI and my assumption that this new reporting will cost each company an additional 1% to 2% of its audit fee depending on whether it is a year of change or status quo for partner and other parties. My estimate is based on fifteen thousand public companies, but there are many other entities to which the proposal may apply, once defined.

My estimate does not include cost of developing databases or the charges that will be made to users of such databases; also, it does not include any assumption for insurance and other costs that may be purchased by audit partners individually or by other parties whose names will be reported.

Virtually all of the costs will be borne by common shareholders. Those doing the work will not do it for free; they will charge the public company. It is unrealistic to believe public companies will increase charges to their customers to cover theses costs. Therefore, the costs will flow to earnings of the reporting entity and its stock price. Economists can estimate, then, whether the costs should be magnified further through the leverage of earnings multiples.

Many will conclude, not without support, **this proposal is a tax imposed on shareholders**. That may not be bad if it can be counted upon to offset those costs with some identified benefits.

LIABILITY

Audit partners, primary audit firms and issuers will have no more exposure to liability; they are the targets now when something goes wrong, as they should be if they were responsible for causing, or negligent in not finding, problems that should have been discovered. The proposal will not change the obligation of the audit firm to support its partners who find themselves in these predicaments. Harmed investors are always going to pursue the firm, not just the partner. The proposal does nothing to reduce or increase firm liability.

However, for other participants, the disclosure of their names and audit role may increase liability. The U. S. Supreme Court **Stoneridge** decision does not condone aiders and abettors, but it does prevent investors from pursuing them, using language like ***"… Respondents had no duty to disclose; and their deceptive acts were not communicated to the investing public during the relevant times. Petitioner, as a result, cannot show reliance upon any of respondents' actions except in an indirect chain that is too remote for liability…"*** Thus, only the government can pursue unidentified aiders and abettors.

However, if this proposal results in "duty" and "communication to the investing public," the chain is more direct and less remote. The new conditions open other participants to private litigation. If so, conditions change for other parties.

I think your interest should be ***transparency***; *liability*, that of others. Both **Stoneridege** and **Janus** were close decisions with five Justices deciding the cases. I do not think even the majority, or Congress, would want the PCAOB to become aiders and abettors. For other aiders and abettors, at least the government can go after them. The commitment in the proposal document to reconsider disclosures later if court decisions tend to hold partners and other participants liable is not a good policy for you.

Questions then arise about this proposal. Definition of "other participants" becomes critical. If a party falls under the definition, the proposal requires that they be disclosed. If the other party will not consent to being disclosed as a participant, the auditor must ask, "Why not?" Is the "other participant" assisting in a deception or are they just being careful? Can a primary auditor overcome the concern and still issue a clean report? Does the new rule, then, still require disclosure of the other participant, along

with disclosure that the other participant would not consent? If investors are to be provided a ***transparent*** picture, the answer is "Yes." Primary auditors' work may increase, relying less on other parties who may refuse to participate, let alone be named. The PCAOB may want to further study this type of development on audit costs and effectiveness, and the objective of making the audit more ***transparent*** to investors.

OTHER QUESTIONS RAISED

Most of the questions you have asked are addressed above, but for others not addressed, let me comment briefly on three of them.

1. **Promotion of competition:** The proposal will not have a significant impact on competition among firms that do audits. It will not relieve the imbalance in the market that results from concentration of audits in four major firms, nor reduce market restrictions that result from conflicts of interest due to non audit work done by firms.

   If the concerns expressed above in the **LIABILITY** section about **Stoneridge** are valid, the proposal may restrict the availability of "other participants."

2. **Form 2:** Your question # 21 asks whether Form 2, or some other report, should be used to report the same information about the audit partner and other participants that auditors will now put in their audit reports. No doubt, some would find Form 2 reporting useful, but I think at present the cost of doing it would outweigh any benefit. Information in Form 2 and other PCAOB forms is static making it difficult to review and some information is restricted under firm confidentiality requests, which, if nothing else, slows the process.

   Most investor questions can be more easily answered by reviewing public filings by the companies in whom they invest. Information about the audit partner and other participants will be in the company report if your proposal is adopted.

   If you are considering that the PCAOB develop the database of information for investors, then you must upgrade the system you have to make it comprehensive and navigable.

   Today, the U. S. firm's do not report on partner disciplinary matters through the Form 2, but choose to use Form 3. The Big 4 firms have disclosed little, if any, of this information on Form 2. The Form 3s disclose information, but the information is required **only for matters affecting issuers**, not for the audit practices in general. In fact, fewer than forty Form 3s have been filed with respect to legal matters for the Big 4, some of those reflecting updates on disciplinary issues and settlements on cases earlier reported. Very few partner names are included in these reports and several of those are quality review partners or accounting advisory partners, not report signing partners. Where there is disclosure of partner names concerning an incident

about which investors might have an interest, a review of the cases only confirms the delay that happens between the incident and its being reported, five years or more in most cases.

For non U. S. firms affiliated with the Big 4, reporting is even sparser. The Form 3s again are the primary reporting document for legal matters and the common disclosure is to report that, pursuant to some unidentified incident for which the U. S. Securities and Exchange Commission has demanded documents, the foreign audit firm will not comply because its government considers it illegal to provide the information. No partner names, no company names are given. Investors can only wonder, "What is that about?"

You may be much further in your consideration of how to identify, gather and upgrade this information than is evident. If not, you have much work to do before this proposal becomes effective. Some reconciliation is needed between the financial statement reporting problems reported in news media and the scantiness of related information in reports filed with you.

3. **Broker dealers and EGCs:** You have several questions about Emerging Growth Companies and brokers and dealers and the impact and usefulness of this proposal for audit of those entities. If you decide the information about audit partners and other participants is useful and necessary, I can think of no overriding reasons that audit reports for these entities should be excluded. The costs are not disproportionately harmful to these entities, and investors will find similar benefit regardless of their portfolio composition.

CONCLUSION AND SUMMARY

Nothing is inherently wrong with the proposition that information sought in this proposal will help investors. However, I do not understand why it is necessary to go through the rule-making process for you to begin requesting and reporting this information. If you change the auditor's report, then a rule is necessary. But, I believe the audit report will then be distracting from the question most of us want answered***: Are the financial statement right?***

An intermediate action, then, would be to develop and expand the information in your reporting requirements, cease honoring confidentiality requests and enhance and streamline the availability of information so that investors can easily get all the information they need about individual auditors and others from the PCAOB. That is the **quickest, easiest and cheapest way to achieve success** for objectives of this proposal.

In the meantime, this proposal has taken much effort and energy, while other developing trends need attention. I think the **significance of audit practices to partner income and wealth was, at one time, the buckle for the "seat belt"** discussed earlier in this letter. But, understandably, firms quickly became limited liability entities when permitted to do so in the mid 1990s; and your Form 2s show that, since 2010, the percent of firm revenues for audits of "issuers" has declined from 28% of total Big 4 revenue to 24.5%. For one of the firms, it is now only 17%. The trend for each firm is down for audit. Form 2's also show the rate of increases in non accounting professionals is more than twice that of accounting

professionals. Big 4 firms consulting practices are expanding much more rapidly than audit practices, some through acquisitions. Compounding disparity in growth rates can be overwhelming. ***Overtime*****, it is not likely that audits will improve as audit practices of these firms become 20%, then 15%, then…**

If true, conflicts of interest, now being rationalized or ignored, will increase; capital investment and research for audit practices, already being redirected, will decrease; market options will become more restricted. Partners' interest in the business of audit and for improving audit effectiveness will decline. When does the title *"independent public accounting firm"* become misleading?

I respect the decision of any business to be what it wants to be and do what it wants to do. But, investors need, the market needs, another "seat belt." It is unrealistic and unfair to lay this responsibility off to investors' review of audit partner personnel files.

I appreciate your efforts in addressing these challenges.

Sincerely,

Gilbert F. Viets