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Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

Re: *Proposed Standard: Improving the Transparency of Audits*
PCAOB Rulemaking Docket Matter No. 029

Deloitte & Touche LLP ("D&T") is pleased to respond to the request for comments from the Public Company Accounting Oversight Board (the "PCAOB" or the "Board") on its *Proposed Standard: Improving the Transparency of Audits*, PCAOB Release No. 2011-007; PCAOB Rulemaking Docket Matter No. 029 (October 11, 2011).

EXECUTIVE SUMMARY

We support transparency regarding the audit process and related quality controls in the interest of promoting the protection of investors and the effective functioning of the capital markets. D&T was one of the first accounting firms in the United States to provide a transparency report to the public describing its governance processes, ethical principles, and quality control procedures. [1] In responding to the Board's proposed standard from this perspective, we offer the following observations:

1. A variety of legal and regulatory provisions now in place are designed to ensure audit engagement partner accountability and the provision of information investors need to make decisions. Further, the Board currently has an agenda project to consider changes in the auditor's report.

2. Should the Board decide that additional measures are called for, options are available to reinforce the functioning of the current system while avoiding unintended adverse effects:

    - Disclose the engagement partner's name in Form 2 reports rather than in both Form 2 reports and audit reports.

    - Include additional language in the audit report that describes the overall level of participation of other firms in the audit, including network member firms, rather than requiring individual disclosure for other participants.

    - If disclosure of other firms' participation is required, adopt a 20 percent threshold rather than a 3 percent threshold, which is generally consistent with the PCAOB's approach in defining whether a firm is playing a "substantial role."

- Resolve the risk of increased liability exposure before imposing new disclosure requirements, for example by coordinating with the Securities and Exchange Commission (SEC) to issue rules designed to counter interpretations that would promote lawsuits and regulatory actions.

CURRENT MECHANISMS PROMOTING TRANSPARENCY

The current environment within which audit firms function contains a variety of mechanisms designed to ensure that audit partners are held appropriately accountable for their work and that investors receive the information they need to make informed decisions:

- PCAOB standards make it clear that the engagement partner is responsible for the audit engagement and the conduct of the audit in accordance with applicable standards.[2]
- Engagement partners are subject to multiple layers of internal quality controls, such as engagement quality reviews, internal inspections, and consultation requirements.
- They are also subject to external oversight, through audit committees, federal and state regulators, the PCAOB, and the threat of civil liability.[3]
- Firms themselves are highly motivated to assure accountability through these internal and external mechanisms, particularly with regard to the quality of engagement partner performance.[4]
- Investors have access to substantial information about public companies through the audit report, management's discussion and analysis, earnings reports, and analyst reports.
- The Board is considering possible means for expanding the usefulness of the auditor's report.[5]

DISCLOSURE OF LEAD ENGAGEMENT PARTNER'S NAME

The standard the Board has proposed would require that the engagement partner's name be disclosed in the audit report and in Form 2 reports that registered public accounting firms file annually with the PCAOB. The features of the existing environment we have cited above address the objectives of the proposed standard concerning auditor accountability and investor information.

Should the Board decide that additional action is required, the most appropriate step would be using Form 2 as the means for disclosure, as opposed to also requiring disclosure in the audit report, for the following reasons:

- As the Board notes in its release,[6] Form 2 can be a more convenient and accessible form of reporting.
- There is less risk of fostering a misperception about how an audit is conducted; although the engagement partner is responsible overall, the performance of the audit requires the work of many professionals and involves the quality control systems of the firm.

- It avoids the potential issue regarding the engagement partner providing a consent, as discussed below.

We are not aware of evidence showing that disclosing an engagement partner's name in the audit report would increase the partner's sense of accountability or that it would cause the engagement partner to exercise greater care in performing the audit.

With respect to providing useful information to investors, knowing the engagement partner's name would be of limited use in making investment decisions. In terms of evaluating the quality of a particular partner's work, the number of issuer audits for which an individual may be the engagement partner, and for which his or her name is disclosed, would represent only a portion of the person's relevant audit engagement experience, other professional experience, education, and training.

For these reasons we suggest that the Board's current agenda project on the auditor's report be the immediate focus for considering potential steps to change the content of that document. Should the Board determine that it should take action at this time on disclosure of the engagement partner's name the more appropriate means would be Form 2.

DISCLOSURE OF OTHER INDEPENDENT ACCOUNTING FIRMS AND PERSONS

The proposal sets forth a 3 percent threshold for the disclosure of other independent firms and participants in the audit based on total hours in the audit for the most recent period, assuming the principal auditor is not dividing responsibility with the participant. As discussed above, the current system provides substantial information for investors, and we suggest that changes in the content of the auditor's report be considered as part of the Board's agenda project on that subject.

Additional explanation on audit participation

Given that the Board is separately considering possible modifications in the auditor's report, there is the opportunity to prescribe the addition of report language that describes the overall level of other firms' participation, including network member firms. An example of how this could be achieved is provided in the letter to the PCAOB from the Center for Audit Quality, submitted in connection with the PCAOB's project to consider additional changes to the auditor's report.[7]

This approach would be of greater value to investors and other users of the report, less likely to cause confusion regarding responsibility for the audit, more readily understandable, and consistent with the Board's objective and other requirements of the Board when the auditor divides responsibility.

Disclosure of other participants

Should the Board decide to require some form of disclosure of other participants in the audit, a 20 percent threshold would be more meaningful to investors and other readers of the financial statements. Firms with participation at that level are those that would be playing a more significant role in the audit. They are generally already defined as playing a "substantial role" by the PCAOB.[8]

At this level of participation it is more likely that the information would be of interest and significance to investors and other readers of the audit report. In addition, the process to calculate the extent of their participation would be significantly less burdensome and distracting from the completion of the audit.

Our concern is that, especially if the 3 percent threshold is applied, disclosing other firms and persons participating in the audit creates the potential for confusing audit report readers. For example, the disclosure of the names of the other auditors may be misinterpreted as indicating the principal auditor has divided responsibility with these auditors or that a joint audit was conducted. With respect to the 3 percent threshold, the following considerations are important:

- The threshold is very low in relation to the significance of the audit work of the participants relative to the overall audit, and the information is likely of limited utility to investors.

- The proposed approach requires a calculation to arrive at a precise participation rate at the report issuance date for each audit participant. Although the PCAOB Staff and the release have indicated that an estimate may be used, the language in the proposed standard does not state this.[9]

- Further, some audit hours will be incurred after the report issuance date. For example, PCAOB Auditing Standard No. 3 *Audit Documentation* allows 45 days from the report issuance date for the audit documentation to be assembled. Thus, some estimation would necessarily be required.

- The lower the threshold, the more time will be taken away from completing the audit to perform the calculations, and the more necessary it will be to use estimates.

Disclosure of certain participating firms having a relationship with the signing auditor

Registered public accounting firms are structured in various ways; some have affiliated firms that are separate legal entities located in the same jurisdiction as that in which the registered firm is located. Their participation in an audit in which the registered firm is the signing auditor is subject to supervision by the registered firm, which takes responsibility for the work of participating firms. In this connection, it would be helpful if the Board were to clarify whether the following interpretations of the proposed standard are correct:

- The legal structure of the registered firm and its affiliates in these circumstances would not affect the application of the disclosure requirements of the proposed standard, and disclosure of the participation in the audit of the affiliates would not be required.

- The participation of a subsidiary controlled by the registered firm located in a different jurisdiction, supervised on the audit by the registered firm, also would not be required to be disclosed.

LEGAL LIABILITY

The Board has made clear its intent that the proposed standard should not increase liability.[10] Further, recent Supreme Court decisions have clarified or confirmed limitations on liability under Section 10(b). One involves what must be shown to prove that an individual or firm made an untrue statement of a material fact (the *Janus* decision).[11] The other addresses what some courts refer to as "scheme liability" or "associational liability" (the *Stoneridge* decision).[12] Proper application of *Janus* and *Stoneridge* to the proposed disclosure requirements should preclude an increase in the liability of the engagement partner or other participants in the audit under Section 10(b) as a result of the proposed disclosures.

Nevertheless, although unintended, the proposed standard would create the potential of an increase in liability or of being made a part of legal and regulatory proceedings for engagement partners and others who would be named as participants in audits. This risk should be resolved before the Board moves forward with the proposed standard.

For example, the Board and the SEC might coordinate to make clear by rule that the engagement partner should not be considered the maker of the statements in the audit report for purposes of liability under Section 10(b) or Rule 10b-5 as a result of his or her name being disclosed under the proposed standard,[13] that any disclosure requirement would not increase liability under Section 11, and that a consent pursuant to Section 7 is not required.[14]

More specifically, the following are the grounds for concern about unintended consequences:

- Plaintiffs can be expected to assert claims under Section 10(b) against named partners and firms notwithstanding the two Supreme Court decisions, and some courts could read them in such a way that merely naming an engagement partner in an audit report will be sufficient to attribute the statements made in the audit report to that engagement partner or provide a basis for "scheme" or "associational" liability.

- The Securities Act of 1933 requires that issuers file the consent of any person (including an accountant) named as having prepared or certified any part of a registration statement (Section 7). It allows claims against such parties (Section 11).[15] Liability under Section 11 does not depend on whether the accountant signed the report. Thus there would be a significant risk if it is determined that engagement partners and other participating firms must file a consent pursuant to Section 7 based on the disclosure of their names.

- Several states either adopted or patterned their securities laws after the Uniform Securities Act, which includes a section modeled after Rule 10b-5(b). Some state courts could, for example, conclude that audit partners and participating firms who are named in an audit report make statements contained in that report and, thus, are liable under state securities laws, even though such a conclusion would be in tension with the *Janus* interpretation of Section 10(b).

- Some states recognize causes of action not merely by buyers and sellers of securities, but also by holders of securities who claim to have relied on false statements. Plaintiffs also could seek to assert claims against named engagement partners and firms under state common law.

- Regardless of how courts rule, simply providing more names to plaintiffs and their counsel would increase the number of claims asserted against engagement partners and other participants who are named. Firms would incur additional costs and experience disruption from such litigation, and from regulatory scrutiny and action.

The potential for unintended consequences underscores the need for the Board to conduct a thorough analysis of the proposal's costs and benefits, and resolve these issues before its adoption.

* * *

D&T appreciates this opportunity to provide our perspectives on this important topic. Our comments are intended to assist the PCAOB in analyzing the relevant issues and potential impacts. We encourage the PCAOB to engage in active and transparent dialogue with commenters as the proposed standard is evaluated and changes are considered. If you have any questions or would like to discuss these issues further, please contact Robert Kueppers at 212-492-4241 or William Platt at (203) 761-3755.

Very truly yours,

/s/ Deloitte & Touche LLP

cc: James R. Doty, PCAOB Chairman
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[1] Advancing Quality Through Transparency, Deloitte LLP 2011. http://www.deloitte.com/view/en_US/us/About/Investor-Confidence/25f9421ee24ce210VgnVCM1000001a56f00aRCRD.htm

[2] See, for instance, PCAOB Auditing Standard No. 9, *Audit Planning*, paragraph 3: "The engagement partner is responsible for the engagement and its performance."

[3] See further discussion of the internal and external oversight processes in the Deloitte & Touche September 11, 2009 letter to the PCAOB.

[4] There are also significant concerns regarding safety and security issues resulting from disclosing individual names, as discussed in our September 11, 2009 letter to the Board. We continue to believe the proposed standard would present significant security concerns for individual partners and their families, and could trigger a reluctance to accept particular audit engagements, e.g., high risk engagements, and further challenge the profession's ability to attract and retain talented professionals. These concerns will also likely involve additional costs in relation to performing certain audits, e.g., arising from the assessment of risks, and putting measures in place to respond to them. We have experienced direct threats to our people as a result of the nature of a client's business operations and of audit findings during the performance of our work.

[5] *See Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements and Related Amendments to PCAOB Standards* available at http://pcaobus.org/Rules/Rulemaking/Pages/Docket034.aspx

[6] See PCAOB release, page 17.

[7] Refer to page 1 of Example A in the Center for Audit Quality's letter available at http://www.thecaq.org/newsroom/pdfs/CAQ_June28Letter_PCAOBRulemakingDocketMatterNo.34.pdf.

[8] As defined in PCAOB Rule 1001, the phrase "play a substantial role in the preparation or furnishing of an audit report" means: (1) to perform material services, i.e., services for which the engagement hours or fees constitute 20 percent or more of the total engagement hours or fees, that an accounting firm uses or relies on in issuing all or part of its audit report with respect to any issuer, or (2) to perform the majority of the audit procedures with respect to a subsidiary or component of any issuer the assets or revenues of which constitute 20 percent or more of the consolidated assets or revenues of such issuer necessary for the principal accountant to issue an audit report on the issuer.

[9] During the open Board meeting on October 11, 2011, it was indicated that firms would be able to use an estimate to arrive at the percentages. Although the release states the auditor may estimate the total hour, it appears limited to "when the actual number of hours have not been reported" by the other participating firms. Significantly, the language in the proposed standard itself does not state that estimates are permitted. *See* PCAOB release, at C-2 "… (3) the percentage of hours attributable to audits or audit procedures performed by the firm(s) or person(s) in relation to the total hours in the most recent period's audit…."

[10] S*ee* PCAOB release, pp. 14-16.

[11] *See Janus Capital Group, Inc. v. First Derivative Traders*, 564 U.S. ---, 131 S.Ct. 2296, 2302 (2011).

[12] *See Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148 (2008).

[13] Additionally, there should be consideration of whether safe harbor protection can be afforded to provide that engagement partners, as a result of being named under the proposed standard, must not be considered to have made the statements within the audit report for the purpose of imposing liability under Section 17(a) of the Securities Act of 1933. Such a clear and definitive rule is of heightened importance in light of the unsettled nature of the impact of *Janus* on Section 17 claims. *Compare SEC v. Daifotis*, No. C 11-00137 WHA, 2011 WL 3295139 (N.D. Cal. Aug. 1, 2011) (holding that the reasoning of *Janus* cannot be extended to Section 17(a)(2) because that section does not contain the word "make") *with SEC v. Kelly*, No. 08-CV-4612, 2011 WL 4431161 (S.D.N.Y. Sept. 22, 2011) (extending the reasoning of *Janus* to a claim under Section

17(a)(2)). Recently, an SEC administrative law judge has agreed with the district court in *Kelly*. *See Primary liability: In the Matter of John P. Flannery*, Adm. Proc. File No. 3-14081 (Initial Decision Dated Oct. 28, 2011).

[14] A requirement that engagement partners provide consents in certain filings based on the disclosure of their names in audit reports could also pose several practical difficulties, including: (1) what to do after a partner retires or otherwise leaves the firm; (2) what to do once a partner rotates off the audit engagement, i.e., would that partner have to perform additional procedures prior to agreeing to consent; and (3) what to do if the issuer switches audit firms. Disclosure of other participants in the auditor's report presents comparable issues – e.g., a requirement that registrants include consents from other participants in connection with certain filings based on disclosure of their names in audit reports would significantly complicate the issuance of a report incorporated by reference into a registration statement and may require several firms to perform subsequent event procedures in order to provide such consents.

[15] *See also* 17 C.F.R. 230.436(b) ("Rule 436(b)"). Rule 436(b) provides that, "[i]f it is stated that any information contained in the registration statement has been reviewed or passed upon by any persons and that such information is set forth in the registration statement upon the authority of or in reliance upon such persons as experts, the written consents of such persons shall be filed as exhibits to the registration statement."