



Via Email

May 23, 2013

Office of the Secretary
PCAOB
1666 K Street, NW
Washington, DC 20006-2803

Re: *Improving the Transparency of Audits: Proposed Amendments to PCAOB Auditing Standards and Form 2 (PCAOB Rulemaking Docket Matter No. 29)*

Dear Madam Secretary:

I am writing on behalf of the Council of Institutional Investors (“CII”). CII is a nonprofit, nonpartisan association of public, corporate, and union employee benefit funds, and other employee benefit plans, foundations and endowments. Our members are long-term shareowners with combined assets that exceed \$3 trillion.¹

The purpose of this letter is to supplement our January 5, 2012 comment letter (“Comment Letter”)² expressing strong support for the Public Company Accounting Oversight Board (“PCAOB”) promptly issuing a final standard in connection with its project on Proposed Amendments to PCAOB Auditing Standards and Form 2 (“Proposal”).³ Since the issuance of the Comment Letter, at least three significant events have occurred that we believe provide further support to requiring the disclosure of the signature or name of the audit engagement partner in the auditor’s report.

1. Revision to CII’s Policies

At the meeting of CII’s general membership last month, the members approved revisions to our existing corporate governance policies on “Auditor Independence.”⁴ Those revisions were the result of an extensive due process, including solicitation and careful consideration of input from a broad range of market participants from both within and outside of our general membership.

¹ For more information about the Council of Institutional Investors (“CII”) and its members, please visit CII’s website at <http://www.cii.org/members>.

² Letter from Jeff Mahoney, General Counsel, to Office of the Secretary 1 (Jan. 5, 2012), http://pcaobus.org/Rules/Rulemaking/Docket029/022b_CII.pdf.

³ Improving the Transparency of Audits: Proposed Amendments to PCAOB Auditing Standards and Form 2, PCAOB Release No. 2011-007, PCAOB Rulemaking Docket Matter No. 29 (Oct. 11, 2011), http://pcaobus.org/Rules/Rulemaking/Docket029/PCAOB_Release_2011-007.pdf [hereinafter Proposal].

⁴ CII Corporate Governance Policies, § 2.13 Auditor Independence (updated 2013), http://www.cii.org/corp_gov_policies#BOD.

The revisions to the Auditor Independence policy contain a number of factors that our general members believe audit committees should consider when exercising their “authority to hire, compensate, oversee and, if necessary, terminate the company’s independent auditor.”⁵ One of those factors, particularly relevant to the Proposal, is the audit committee’s evaluation of the “track record of the lead partners and the extent of their professional commitments”⁶ In describing that factor, the new policy language explicitly reflects our members’ view that one efficient tool for collecting information about the lead audit partner is “through disclosure or signature of the lead partner on the auditor’s report.” That view appears to confirm the validity of the view described in the Proposal that many believe “providing financial statement users, audit committees, and others with the name of the engagement partner [in the audit report] might provide them the opportunity to evaluate, to a degree, an engagement partner’s experience and track record.”⁷

2. *The London Incident*

As you are aware, on April 9, 2013, KPMG LLP (“KPMG”) issued a public statement indicating that an unnamed audit partner was separated from the firm for his involvement in providing non-public client information to a third party in exchange for cash.⁸ While investors and the general public learned within one day of the KPMG statement that Scott London was the unnamed partner and that Mr. London was the audit partner on Herbalife and Skechers,⁹ it was not until *three days later* that investors and the general public learned of the existence of three other audit clients of Mr. London—Deckers Outdoor Corp., RSC Holdings and Pacific Capital.¹⁰

Unfortunately, questions about Mr. London’s involvement with other audit clients remains. In an April 23, 2013 article in the Financial Times, Michael Andrew, the chairman of KPMG, indicated that he was “prevented by confidentiality requirements from revealing *what other companies’ audits were led by Mr. London.*”¹¹

⁵ § 2.13a Audit Committee Responsibilities Regarding Independent Auditors.

⁶ *Id.*

⁷ Proposal at 6.

⁸ Michel Cohn, *KPMG Resigns from Herbalife and Skechers Audits after Senior Partner is Implicated in Insider Trading*, Acct.today, Apr. 9, 2013, at 1-2, <http://www.accountingtoday.com/news/KPMG-Resigns-Herbalife-Skechers-Audits-Insider-Trading-66307-1.html>.

⁹ *Id.*

¹⁰ Michael Cohn, *PCAOB Could Toughen Auditor Rules after KPMG Insider Trading Case*, Acct.Today, Apr.12, 2013, http://www.accountingtoday.com/debits_credits/PCAOB-Auditor-Rules-KPMG-Insider-Trading-Case-66350-1.html [hereinafter Cohn article].

¹¹ Patti Waldmeir & Kara Scannell, Fin. Times, *KPMG chief dismisses ‘one-day wonder’ scandal*, Apr. 23, 2013, at 1 (emphasis added), <http://www.ft.com/intl/cms/s/0/cdbae386-abfa-11e2-9e7f-00144feabdc0.html#axzz2U8ic3fBb>.

The delay and continued uncertainty surrounding which companies' audits were led by Mr. London is of concern to investors and shareowners. Commenting on those concerns, a former enforcement attorney with the U.S. Securities and Exchange Commission and the Financial Industry Regulatory Authority recently stated:

Even once the name of the auditor partner was disclosed, you had no idea what other audits he may have been leading. And as an investor, it would have been very interesting to know what other audits he was leading because they were likely to have implications as well, so it wouldn't just be Herbalife and Skechers, but maybe others.¹²

Moreover, the London incident occurred during proxy season when over a period of a just few weeks literally millions of American shareowners are voting proxies at thousands of U.S. public companies. One of the more consequential votes that shareowners cast annually at most of those companies, consistent with CII membership approved policies,¹³ is a vote on the ratification of the independent, external auditor.¹⁴ Recent empirical evidence indicates that shareowner voting on auditor ratification increases audit quality.¹⁵

In our view, as soon as news about Mr. London's conduct had been reported publicly, every shareowner in America should have had the ability to immediately access information to determine whether Mr. London was the audit engagement partner at the company they own. That information would certainly have had some relevance for some shareowners in determining how to vote on management's proposal to ratify the choice of outside auditor. We believe that adoption of the Proposal would provide the means for shareowners to more efficiently obtain that information.

3. Empirical Evidence Supporting the Proposal

In February 2013 a paper was accepted for publishing by the American Accounting Association providing empirical evidence in support of the Proposal.

¹² Cohen article at 1.

¹³ § 2.13f Shareowner Votes on the Board's Choice of Outside Auditor ("Audit Committee charters should provide for annual shareowner votes on the board's choice of independent, external auditor.")

¹⁴ A review of Institutional Shareholder Services Inc. Voting Data by CII staff reveals that 2,739 companies in the Russell 3,000 had management proposals asking shareowners to vote on whether to ratify the company's choice of independent external auditors in calendar year 2012.

¹⁵ Mai Dao et al., *Shareholder Voting on Auditor Selection, Audit Fees, and Audit Quality*, 87 *Acct. Review* 149 (Jan. 2012), <http://aaajournals.org/doi/abs/10.2308/accr-10159> (subscription required) (finding "that in firms with shareholder voting on auditor selection (1) subsequent restatements are less likely and (2) abnormal accruals are lower").

More specifically, the paper investigated the conclusion of the U.S. Department of the Treasury's Advisory Committee on the Auditing Profession ("ACAP") that "the engagement partner's signature on the auditor's report would increase transparency and accountability."¹⁶ Prepared by Joseph V. Carcello, Professor, University of Tennessee and Chan Li, Assistant Professor, University of Pittsburg, the paper examined whether financial reporting outcomes changed in the United Kingdom after their introduction of the partner signature requirement in 2009.¹⁷

The paper's findings, generally confirming the conclusion of ACAP and one of the bases of CII's support for the Proposal,¹⁸ include the following:

Overall, our results indicate that the implementation of a partner signature requirement in the U.K. has offered benefits to investors and other financial statement users. First, earnings management has declined, whether measured by abnormal accruals or the propensity to meet an earnings threshold. In addition, the incidence of qualified audit opinions has increased. Perhaps because of this decline in earnings management and/or because of a greater willingness by auditors to issue qualified opinions, the informativeness of earnings has increased. Importantly, the results for both control samples – U.S. firms which have not implemented a signature requirement, and firms in other European Countries that adopted the partner signature requirement before the U.K. – suggest that the audit quality improvements experienced in the U.K. after the partner signature requirement are unlikely to be due to other changes in the audit or business environment not included in our model.

*. . . .
. . . . Our results are consistent with the argument that requiring an individual audit partner to sign a report improves audit quality by increasing the partner's accountability and transparency of audit reporting*¹⁹

¹⁶ U.S. Department of the Treasury, *Final Report of the Advisory Committee on the Auditing Profession to the U.S. Department of the Treasury* VII:120 (Oct. 6, 2008), <http://www.treasury.gov/about/organizational-structure/offices/Documents/final-report.pdf>.

¹⁷ Joseph V. Carcello et al., *Costs and Benefits of Requiring an Engagement Partner Signature: Recent Experience in the United Kingdom* (Jan. 16, 2013), <http://www.docstoc.com/docs/149993970/Costs-and-Benefits-of-Requiring-an-Engagement-Partner-Signature> (registration required) (Acct. Rev. forthcoming).

¹⁸ Letter from Jeff Mahoney at 2.

¹⁹ Joseph V. Carcello at 7 (emphasis added).

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For all of the above reasons and those cited in the Comment Letter, CII continues to strongly support the prompt issuance of a final standard implementing the Proposal. We thank you for considering the views of long-term investors. Please feel free to contact me at 202.261.7081 or jeff@cii.org with any questions regarding the content of this letter.

Sincerely,

A handwritten signature in black ink that reads "Jeff Mahoney". The signature is written in a cursive, flowing style.

Jeff Mahoney
General Counsel