September 7, 2015

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

RE: Supplemental Request for Comment: *Rules to Require Disclosure of Certain Audit Participants on a New PCAOB Form* (PCAOB Release No. 2015-004; Docket Matter No. 029)

Dear Board Members and Staff:

I am writing to provide input on the Board's deliberations regarding whether to disclose the identity of the engagement partner and certain other audit participants. My views are informed by many years performing research related to audit and governance-related regulation, including research directly applicable to the issue of identifying the audit engagement partner. In addition, my views reflect my years serving on the PCAOB's Investor Advisory Group (IAG) (2010-2015), years serving on the PCAOB's Standing Advisory Group (SAG) (three 2-year terms between 2006 and 2012), and my current service on the SEC's Investor Advisory Committee (IAC) (2014-2018). The issue of identifying the engagement partner has been discussed on multiple occasions by the IAG and SAG, and I have benefitted from private conversations with certain members of the SEC's IAC.

Identification of the Engagement Partner

Investors and investor advocates, particularly institutional investors, have been consistent in their support of requiring the identification of the engagement partner. A large majority of members of the PCAOB's IAG have favored disclosing the name of the engagement partner when this issue has been discussed at our meetings. Moreover, by my count the PCAOB has received 13 comment letters from institutional investors or investor advocacy groups on its "Supplemental Request for Comment" – all 13 of these comment letters support the identification of the engagement partner.[1] Most of these investor comment letters prefer the disclosure of the engagement partner's identity in the audit report and, in fact, some prefer that the engagement partner be required to sign the audit report (e.g., AFL-CIO, CalPERS). However, with one exception (Bersot Capital Management), these investor groups are willing to accept, with varying degrees of enthusiasm, the disclosure of the engagement partner's identity on a new Form AP as a compromise solution.

I strongly favor the disclosure of the engagement partner's identity as well. Three options for such disclosure have been considered: (1) requiring the engagement partner's signature in the audit report

[1] The 13 organizations are: Council of Institutional Investors, Mandarin Capital Partners, Sinclair Capital LLC, CalSTRS, Hermes, Bersot Capital Management, Muddy Waters Research, Colorado PERA, CFA Institute, AFL-CIO, Worker Owner Council of the Northwest, CalPERS, and The Investment Association.

(the PCAOB originally suggested this possibility), (2) requiring the disclosure of the engagement partner's name in the audit report (a number of PCAOB releases have considered this possibility), and (3) requiring the disclosure of the engagement partner's name in a new form (at this point, the option being considered is a new form -- Form AP). In my view, the weakest of these three options is disclosing the engagement partner's name on Form AP (a view shared with Muddy Waters' comment letter). Notwithstanding the limitations associated with Form AP (elaborated on below), I believe that disclosing the name of the engagement partner on Form AP is a noticeable improvement over current practice and will achieve the transparency benefits that the PCAOB seeks from this project. Disclosure of the engagement partner's name on Form AP may achieve accountability benefits, especially over time, but any such benefits are likely to be weaker than if the engagement partner had been identified in the audit report and weaker still than if the engagement partner had to sign the audit report. But given the opposition of the public accounting profession to disclosing the name of the engagement partner in the audit report, and the general willingness of the accounting profession to accept disclosure on Form AP, the compromise solution developed by the PCAOB seems reasonable.

Disclosing the engagement partner's name on Form AP will achieve the transparency benefits the PCAOB is seeking and, although investors will incur slightly higher search costs, investors will benefit from visibility as to all of the audit engagements performed by individual partners (a number of the investor comment letters made this point). In addition, these transparency benefits may affect audit committee incentives to seek engagement partners that develop a reputation for providing higher quality services (see p. A2-6 of the PCAOB's proposal). But the accountability effects of identifying the partner via Form AP are likely to be weaker than identifying the partner in the audit report because the partner will read the audit report that identifies him or her by name. Simple human experience suggests that seeing one's name in a public document – being broadly identifiable – is likely to affect behavior. Conversely, the engagement partner will almost certainly not prepare and file the Form AP.[2] Firms will likely view filing the form as a simple compliance exercise, and the engagement partner will probably not even know when the form is being filed. Nevertheless, requiring disclosure of engagement partner identity on Form AP seems like a solution that all sides on this debate can accept, and I encourage the PCAOB to move forward expeditiously in adopting a final rule.

A small technical comment – the Board needs to retain the proposed requirement in Item 3.1a6 to require the disclosure of the partner's first, last, and middle name – not middle initial, middle name. Although I am uniquely identified with a middle initial, a partner named "John W. Smith" may not be.

Identification of Certain Other Audit Participants

Disclosing the identity and role played by other accounting firms in performing audits is also critical. This disclosure is particularly germane for audit firms located in jurisdictions that deny PCAOB inspections (i.e., China in particular, but also certain countries in Europe).

I am concerned with the language in the "Supplementary Request" that would not require disclosure if "nonaccounting firm participants were controlled by or under common control with the accounting firm issuing the auditor's report" (see p. 10). As the PCAOB recognizes, such a requirement could create the perverse incentive to use a nonaccounting firm rather than an accounting firm in order to avoid disclosure requirements (see p. 13). For example, could a US auditor form an entity in China, a

[2] The PCAOB seems to recognize that Form AP may have a less salutary effect on enhancing accountability than identifying the partner in the report (p. A2-25).

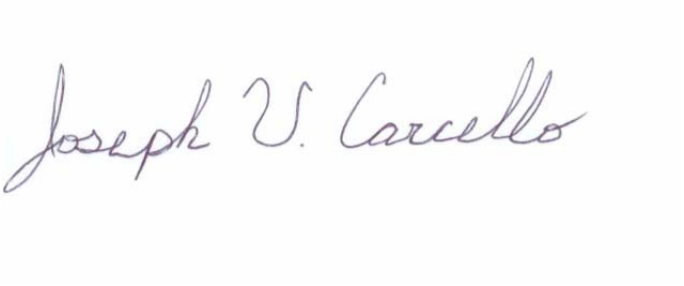
nonaccounting firm, to perform audit-like procedures on SEC registrants located in China? Since this nonaccounting firm would be controlled by the accounting firm issuing the audit report disclosure of its role would presumably not be required. Not only would lack of disclosure in this case be problematic, the language of this proposed rule may actually serve to encourage such suboptimal behavior from an audit quality perspective. I encourage the Board to never underestimate the risk of "bad actors" attempting to "game" the system.

I am also concerned with the language in the "Supplementary Request" to exclude specialists engaged, even if not employed, by the auditor (see p. 11). The ostensible reason for this change is to not disadvantage smaller auditing firms. But what if the specialist engaged by the smaller auditor is also engaged by management? This is problematic, and would need to be addressed in any final Board rule. A specialist employed by the auditor is simply more appropriate than an outside specialist engaged if that outside specialist also works for management of the audited entity.

A smaller technical comment – in Item 4.1b and Item 5.1a2, the proposed disclosure is based on the country of the headquarters office. I may be missing a nuance here, but it seems to me that the risk to investors is based on the location of the office primarily responsible for the audit work. For example, assume ABC Inc. is an SEC registrant with a large subsidiary located in Shanghai. The US audit firm, who signs the report in the 10-K, is based in NY, and uses an overseas audit firm for the Shanghai-based subsidiary. Let's assume that ABC Inc. does not want investors to know that a substantial part of the audit is performed by a firm based in China that is not subject to PCAOB inspections. It would seem that the US audit firm could retain a foreign firm, let's call the firm "Non-China Foreign Firm", whose headquarters are elsewhere but that has a major presence in China. The actual work would be done by the *Chinese office* (my emphasis) of "Non-China Foreign Firm" but the audit report would disclose that the work was done by "Non-China Foreign Firm". And if "Non-China Foreign Firm" is located in a country that allows PCAOB inspections all would seem well to investors when the reality is quite different and undisclosed, unless I misunderstood this section of the PCAOB's proposed rule.

Thank you for considering my suggestions.

Sincerely,



Joseph V. Carcello
Department Head – Accounting & Information Management
Executive Director – Neel Corporate Governance Center
EY and Business Alumni Professor
Haslam College of Business, University of Tennessee