Fund Democracy
Consumer Federation of America

March 17, 2014

FILED ELECTRONICALLY

Phoebe W. Brown
Office of the Secretary
Public Company Accounting Oversight Board
1666 K St., NW
Washington, DC 20006-2803

Re: PCAOB Rulemaking Docket Matter No. 029

Dear Ms. Brown,

We greatly appreciate the opportunity to comment on behalf of Fund Democracy and the Consumer Federation of America[1] on the Public Company Accounting Oversight Board's ("PCAOB" or "Board") proposal to require, among other things, that audit firms disclose the name of the audit engagement partner in the auditor's report.[2] The Board's leadership on this and other issues has been a beacon of hope for those who continue to believe that effective regulation is a necessary condition of efficient financial markets. We applaud the Board's proposal and urge its expedited adoption.

We strongly agree that naming the engagement partner will improve audit by incentivizing the partner to exercise greater diligence and more forceful leadership. As one commentator has noted regarding the similar certification requirement for public company CEOs and CFOs, "when people know they can and will be held accountable for their actions, their behaviors change."[3] As recognized by virtually all commentators on the Board's proposal, including its critics, naming the engagement partner will have the effect that personal accountability invariably has on responsible individuals. Engagement

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[1] Fund Democracy is a non-profit investor advocacy group of which Mr. Bullard is the founder and CEO. Ms. Roper is the Director of Investor for the Consumer Federation of America, which is a non-profit association of nearly 300 national, state, and local pro-consumer organizations that was formed in 1967 to represent the consumer interest through research, advocacy and education. Although we are also members of the PCAOB's Investor Advisory Group, these comments are not those of the Group and do not necessarily reflect its views.

[2] *See* 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, PCAOB Release No. 2013-009 (Dec. 4, 2013) ("Re-Proposing Release") *available at* http://pcaobus.org/Rules/Rulemaking/Docket029/PCAOB%20Release%20No%20%202013-009%20-%20Transparency.pdf.

[3] Ronald E. Marden, Randal K. Edwards, and William D. Stout, *The CEO/CFO Certification Requirement*, The CPA Journal (July 2003) *available at* http://www.nysscpa.org/cpajournal/2003/0703/features/f073603.htm.

partners will be more careful, thorough, independent and uncompromising when investors are informed about the engagement partners' critical role in the audit process.

The market for audit services will become more efficient with improved transparency as public companies and the users of financial information will be better able to evaluate the skill, experience and record of the audit's primary supervisor. For example, naming the engagement partner will help them assess the impact of changes in the engagement partner on the quality of the audit. The engagement partner's professional reputation will be directly tied to the audit, thereby enhancing accountability. Finally, naming the engagement will strengthen investor confidence in public company financial statements and thereby facilitate capital formation.

The Board's proposal will enhance the reliability of financial statements for all public companies. We therefore believe that no exceptions should be made for emerging growth companies, for which a series of ill-advised regulatory exemptions already threaten investor confidence. If subpar engagement partners can escape public scrutiny simply by overseeing audits of emerging growth companies, then exempting these companies will guarantee that their audits will be subpar as well.

Professional Standards of Accountability

The naming proposal will subject public accountants to widely accepted standards of accountability for professionals. Doctors, lawyers and other professionals are routinely required to assume personal responsibility for their work. Doctors take responsibility for distributing medicine by personally signing prescriptions. Lawyers take responsibility for the truthfulness of legal filings by personally signing court documents. In neither case would reasonable persons argue that personal responsibility degrades performance. Rather, personal responsibility is considered a necessary condition of providing high-quality professional services.

In other contexts, the law has recognized the importance of holding individual gatekeepers of the integrity of public companies' financial statements accountable for their public trust. For example, the Federal Reserve Board requires that bank holding companies name their audit engagement partners, and the European Union requires that its members adopt a similar requirement. Public company CEOs and CFOs have long provided public assurances regarding their firms' financial statements. For example, they are subject to a *de facto* requirement to provide a Management Representation Letter[4] that attests to an exhaustive list of specific matters relating to the audit. These matters are too lengthy to include in this letter, but notably include representations regarding:

- Management's acknowledgment of its responsibility for the fair presentation in the financial statements of financial position, results of operations, and cash flows in conformity with generally accepted

[4] Management Representation Letter, AU § 333 (eff. 1998) *available at* http://www.aicpa.org/Research/Standards/AuditAttest/DownloadableDocuments/AU-00333.pdf.

accounting principles;

- Management's belief that the financial statements are fairly presented in conformity with generally accepted accounting principles;

- Management's acknowledgment of its responsibility for the design and implementation of programs and controls to prevent and detect fraud;

- Knowledge of fraud or suspected fraud affecting the entity involving (1) management, (2) employees who have significant roles in internal control, or (3) others where the fraud could have a material effect on the financial statements;

- Knowledge of any allegations of fraud or suspected fraud affecting the entity received in communications from employees, former employees, analysts, regulators, short sellers, or others; and

- Information concerning related-party transactions and amounts receivable from or payable to related parties.

Audit engagement partners should not be allowed to abjure any public, personal responsibility for the fulfillment of their public duties while other gatekeepers of public company financial statements attest personally in public certifications that they have fulfilled their public duties.

The Sarbanes-Oxley Act of 2002 further expanded executives' personal responsibility for the integrity of public company financial statements. Section 302 of the Act requires that the CEO and CFO include in public reports submitted under Sections 13 and 15 of the Exchange Act a certification to accompany the audit report:

> that [is] based on such officer's knowledge, the financial statements, and other financial information included in the report, [and] fairly presents in all material respects the financial condition and results of operations of the issuer as of, and for, the periods presented in the report.[5]

The Act's emphasis on the CEO's and CFO's public assumption of personal responsibility for the integrity of their firms' financial statements is reinforced by its provisions that increase fines and sentences for executives' misconduct. As noted by commentators:

> The Sarbanes-Oxley Act's mandatory responsibility requirement would appear to be a clear improvement over previous practice. With potentially

[5] *See also* Exchange Act Rules 13a-14 and 15d-14 (requiring that an issuer's principal executive and financial officer each certify that they have reviewed the issuer's quarterly and annual reports and "that information contained in the periodic report fairly presents, in all material respects, the financial condition and results of operations of the issuer.").

> larger fines and even prison terms for noncompliance with Sarbanes-Oxley requirements, executive management will likely give more thought and care to the certification process. . . . Consequently, now that executives are being held personally responsible for their companies' financial statements, they must worry more than ever about their personal bottom lines.[6]

There is no doubt that strengthening the personal accountability of audit partners will cause them "to give more thought and care" to the fulfillment of their responsibilities as well. It is starkly incongruous for public company CEOs and CFOs to assume public responsibility for the integrity of their firms' financial statements while the engagement partner who is primarily responsible for the quality of the audit is allowed to remain concealed from public view.

The naming of the engagement partner, as the Board points out, is only a first step. Additional disclosure is needed regarding the background of individuals who are primarily responsible for the conduct of an audit. For example, securities brokers are required to provide extensive disclosure of their disciplinary history and other background information. This disclosure enables the public to evaluate a broker's record while creating incentives for brokers to comply with the law and treat their customers fairly. These requirements contrast sharply with what Senators Levin and Coburn aptly described as "a long history of excessive secrecy and weak accountability for U.S. public company audits."[7]

No public record exists for CPAs that is similar to what is available for brokers. The American Institute of Certified Public Accountants posts online CPAs' disciplinary actions by year rather than by CPA, it provides no effective means of searching disciplinary information by individual, and it removes notices of suspensions from its website one year after the suspension ends. If a CPA is reinstated after being terminated, the record of the termination is removed five years after reinstatement.

Public debate currently rages about the precise level of detail and currency of disclosure of brokers' disciplinary history, yet no similar system of public disclosure regarding any CPA's – much less any engagement partner's – disciplinary history even exists. This contrast turns logic on its head. While CPAs, who serve in a formal quasi-governmental capacity, are not subject to public disclosure requirements, brokers must provide extensive, detailed disclosure for a database. The broker database is appropriately

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[6] *The CEO/CFO Certification Requirement*, *supra* note 3.

[7] Letter from the Honorable Carl Levin and the Honorable Tom Coburn, U.S. Senate (Feb. 3, 2014) *available at* http://pcaobus.org/Rules/Rulemaking/Docket029/020c_Levin-Coburn.pdf. *See also The 10th Anniversary of the Sarbanes-Oxley Act*, Hearing before the Subcommittee on Capital Markets and Government Sponsored Enterprises, Committee on Financial Services, United States House of Representatives (July 26, 2012) (testimony of Mercer Bullard discussing *de facto* prohibition on public disclosure of PCAOB proceedings against auditors).

named "BrokerCheck;"[8] a "CPACheck" is long overdue and should be the next item on the Board's agenda.

Social Benefits of Legal Liability

Some commentators have expressed concern that naming the engagement partner may increase litigation costs and expose the partner to personal liability. What is missing from these comments, however, is any recognition that legal liability can and does serve a valuable social purpose.[9] In a time when some legal reforms seem based solely on the proposition that legal liability has no social benefit, it is important to remember that legal liability is a foundational principle of the rule of law and, indirectly, of western civilization. Some recent legal reforms have promoted a Hobbesian legal regime in which companies can sell inherently dangerous products, doctors can commit egregious malpractice, insurance companies can recklessly deny claims, and investment bankers can bring society to the brink of financial collapse ***often with virtual impunity***, but this is no reason for the Board to accede to the argument that actors should not be held responsible for their actions.

In some respects, we are concerned that the Board's discussion of legal liability may be interpreted to reflect the view that regulators should always seek to minimize litigation risk.[10] The Board should, of course, consider the potential costs of frivolous lawsuits, but it should also stand firmly for the proposition that private and public liability is a critical component of effective regulation. To the extent that the Board's proposal increases the likelihood that appropriate persons will be subject to liability under the securities laws, it should promote its proposal as creating a positive social benefit.[11]

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[8] "BrokerCheck is a free tool to help investors research the professional backgrounds of current and former FINRA-registered brokerage firms and brokers, as well as investment adviser firms and representatives. BrokerCheck information is drawn from filings by regulators, firms and investment professionals. It includes current licensing status and history, employment history and, if any, reported regulatory, customer dispute, criminal and other matters. It should be the first resource investors turn to when choosing whether to do business or continue to do business with a particular firm or individual." FINRA BrokerCheck at http://www.finra.org/Investors/ToolsCalculators/BrokerCheck/.

[9] *See*, *e.g.*, Letter from McGladrey LLP (Jan. 29, 2014) *available at* http://pcaobus.org/Rules/Rulemaking/Docket029/011c_McGladrey%20LLP.pdf. We note that McGladrey's comment letter is not signed by its author.

[10] *See*, *e.g.*, Re-Proposing Release at 20 - 21 ("[w]hile the Board has not sought to increase the risk that an engagement partner would be held liable in private litigation, it has recognized and, where it could, consistent with its policy objectives, tried to mitigate this possibility . . . the Board believes that any possible increases in a named engagement partner's or participating accounting firm's exposure to liability should be limited").

[11] Final Report of the Advisory Committee on the Auditing Professional to the U.S. Department of the Treasury at VII:30 – 31 (Oct. 6, 2008) ("ACAP Report") ("Easing auditor liability adversely impacts investor perception of audit quality and confidence in audited financial statements because most investors, consistent with the view of many market participants and the results of numerous academic studies, have concluded that auditing firms would reduce the intensity of their audits if the risk of litigation is further minimized. . . . Auditing firms would reduce the quality of their audits if the threat of litigation were to be

Indeed, the risk of justified personable liability is arguably accountability's sharpest edge, yet rather than asserting this benefit the proposal seems to apologize for it.[12]

We urge the Board to clarify that it seeks to mitigate only the possibility of *unjustified* private liability and note that any increase in *justified* private (and public) liability constitutes one of the many benefits of the proposal.[13] Otherwise, the Board risks providing implicit support for popular attacks on the legitimacy of legal liability as a tool of effective public policy.

Liability Considerations

We are also concerned that the issue of legal liability has not been properly framed. The naming of the engagement partner does not, of course, represent actionable misconduct in and of itself. Any incidental liability can only be based on illegal conduct that is independent of the naming of the partner.[14] In other words, a person cannot be held liable simply because they were the engagement partner or they were named as such.

Commentators' actual liability concern may be the perceived risk that merely naming the engagement partner may independently support a finding of legal responsibility for illegal conduct. In other words, the mere allegation that the partner was named may alone sustain a private or public claim that the partner was legally responsible for the alleged misconduct. However, we are unaware of *any* evidence that naming the engagement partner will affect the factual predicate[15] needed to sustain a legal claim.[16]

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reduced." (citations omitted)) *available at* http://www.treasury.gov/about/organizational-structure/offices/Documents/final-report.pdf.

[12] "Private litigation is an important supplement to regulatory activity in ensuring accountability and confidence in our financial markets." *Id.* at II:7.

[13] For example, the Board removed the phrase "responsible for the audit" in examples of audit reports to address liability concerns, Re-Proposing Release at 26, yet that is exactly what an engagement partner is – "responsible for the audit." Indeed, the term "engagement partner" is defined as the "member of the engagement team with ***primary*** responsibility for the audit." Appendix A, Auditing Standard No. 9 (emphasis added). Rather than deleting the offending, yet truthful phrase, the Board should consider adding the word "primarily." Another example appears where the Board states that "there could be indirect costs to engagement partners and other audit participants related to obtaining representation in cases when they may not have been named before." Re-Proposing Release at 31. We encourage the Board to note that there could be indirect benefits resulting from the possibility that such persons may be held personally accountable. Where the Board discusses potential liability of engagement partners under the *Janus* standard (that is, when they may be found to be a "maker" of a statement in a public filing), *id*. at 24 – 26, it could clarify that, if an engagement partner makes a statement for purposes of *Janus*, then the partner *should* be legally responsible for that statement.

[14] *See* Proposing Release at 23 ("the engagement partner's liability would be based on the same facts that already subject the firm to liability").

[15] The Board assumes that the legal predicate for liability under Section 11 of the Securities Act would exist because the engagement partner would be viewed, for purposes of Section 7 of the Act, as "having prepared or certified any part of the registration statement, or is named as having prepared or certified a report or

Rather, naming the engagement partner will ensure that fraud does not go unpunished simply because identifying the individuals who were responsible for the audit is too difficult. Critics of the Board's proposal correctly recognize that naming the engagement partner will prevent the partner from denying that he or she was the "member of the engagement team with primary responsibility for the audit."[17]

The clear allocation of personal responsibility for established violations of the law has been the most significant impediment in prosecuting white-collar wrongdoing. Entities, including audit firms, cannot violate the law without the actions of individually responsible persons.[18] Every instance of fraud must have one or more human authors. All too often, however, private and public claims against individuals are stymied because no evidentiarily sufficient causal path can be traced to them. These responsible individuals exist – an entity can act only through its agents – but they are able to hide behind a haze of corporate bureaucracy that has been the downfall of countless private and public financial fraud prosecutions. Individual responsibility is clear when bonuses are awarded, but only the face of the employer is visible when accountability is sought for fraud.

Naming the engagement partner is a first and necessary step to ensuring that auditing misconduct can be traced to its architects. As noted by the Board, "[i]t is

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valuation for use in connection with the registration statement." *Id.* at 21 - 22. We do not agree that it is self-evident that acting as engagement partner necessarily equates to having "prepared or certified" The Board's General Counsel has implied that this is at least an open question and that "the SEC could issue a safe harbor rule." *See* Financial Reporting Blog (October 2011) (stating: "the issue is whether the SEC would require a Section 7 consent") *available at* http://www.financialexecutives.org/KenticoCMS/FEI_Blogs/Financial-Reporting-Blog/October-2011/PCAOB-Proposes-Disclosure-of-Engagement-Partner,-O.aspx#ixzz2wDKA8qRL. The SEC expressly found that the designation of an audit committee financial expert did not have any effect on potential Section 11 liability and, out of an abundance of caution, adopted a safe harbor to that effect. *See* Disclosure Required by Sections 406 and 407 of the Sarbanes-Oxley Act of 2002, Securities Act Rel. No. 8177 (Jan. 23, 2003) (adopting CFR § 228.401(e)(4)). The Board should discuss any consultations it has had with the SEC regarding a safe harbor that would provide, for example, that an engagement partner shall not be deemed to have "prepared or certified" for purposes of the Securities Act solely by reason of having been named as the engagement partner

[16] *See* ACAP Report at VII:20 ("The Committee notes the signature requirement should not impose on any signing partner any duties, obligations or liability that are greater than the duties, obligations and liability imposed on such person as a member of an auditing firm.").

[17] Appendix A, Auditing Standard No. 9 (defining "engagement partner").

[18] *See* The Honorable Jed Rakoff, *The Financial Crisis: Why Have No High-Level Executives Been Prosecuted?* N.Y. Rev. Books (Jan. 9, 2014) ("you should not indict or threaten to indict a company unless you can prove beyond a reasonable doubt that some managerial agent of the company committed the alleged crime; and if you can prove that, why not indict the manager? And from a moral standpoint, punishing a company and its many innocent employees and shareholders for the crimes committed by some unprosecuted individuals seems contrary to elementary notions of moral responsibility.") *available at* http://www.nybooks.com/articles/archives/2014/jan/09/financial-crisis-why-no-executive-prosecutions/?pagination=false.

indisputably true that the engagement partner plays a unique role in the audit."[19] Naming engagement partners will deny them the comfort of plausible deniability when misconduct comes to light. Rather, they will know from the outset that they will be held responsible for oversight of the audit that they oversee. Naming the engagement partner will not create or support liability where, for example, rogue subordinates engage in misconduct that oversight procedures failed to detect if the procedures are reasonably designed and implemented. Legal liability for failed oversight will only stick where the engagement partner has failed to fulfill his oversight duties.

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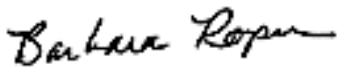
We applaud and strongly support the PCAOB's proposal to require the naming of engagement partners and encourage the Board to pursue additional transparency improvements. The grant of privileged, statutory status to public accounting firms must be matched by heightened accountability, but assigning responsibility only to the firms is not enough. Meaningful accountability begins and ends with the kind of personal responsibility that honest, diligent accountants embrace and demand for their peers. The naming of engagement partners will remove anonymity from a process that calls for greater transparency and begin to create a culture of personal accountability for public company accountants.

Sincerely,

Mercer Bullard
President and Founder
Fund Democracy, Inc.



Barbara Roper
Director of Investor Protection
Consumer Federation of America

cc by Email and/or U.S. Mail:

PCAOB:
Honorable James R. Doty, Chairman
Honorable Lewis H. Ferguson, Board Member
Honorable Jeanette M. Franzel, Board Member
Honorable Jay D. Hanson, Board Member
Honorable Steven B. Harris, Board Member

Martin F. Baumann, Chief Auditor
J. Gordon Seymoure, General Counsel

[19] Re-Proposing Release at 13.

SEC:
Honorable Mary Jo White, Chairman
Honorable Luis A. Aguilar, Commissioner
Honorable Daniel M. Gallagher, Commissioner
Honorable Kara M. Stein, Commissioner
Honorable Michael S. Piwowar, Commissioner

Keith Higgins, Director, Division of Corporation Finance
Anne K. Small, General Counsel, Office of General Counsel