CENTER FOR CAPITAL MARKETS COMPETITIVENESS

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

Re: PCAOB Rulemaking Docket Matter No. 030

Dear Members and Staff of the Public Company Accounting Oversight Board:

The United States Chamber of Commerce ("Chamber") is the world's largest business federation representing more than 3 million businesses and organizations of every size, sector, and region. The Chamber created the Center for Capital Markets Competitiveness ("CCMC") to promote a modern and effective regulatory structure for capital markets to fully function in a 21st century economy.

The CCMC recognizes the vital role that external audits play in capital formation and supports efforts to improve audit effectiveness. Communications between auditors and audit committees is an important part of that process and we appreciate the opportunity to comment on the Public Company Accounting Oversight Board's ("PCAOB") *Proposed Auditing Standard Related to Communications with Audit Committees* ("Proposal").

An updating of the PCAOB's Interim Auditing Standards on auditor-audit committee communications is needed particularly with the changes that have occurred since the implementation of the Sarbanes-Oxley Act of 2002 ("SOX"). However, the proposal only concerns one side of the communication process, without a full appreciation of the entire dialogue that occurs in the management of a public company. The PCAOB has no authority over directors and management and appears to have not taken into account their roles in this process. This has harmed the proposal and hampered the ability of the PCAOB from achieving its intent.

The CCMC therefore requests that the PCAOB engage in further outreach to better understand all aspects of auditor-audit committee communications. Moreover, we encourage you to engage the Securities and Exchange Commission in this outreach due to its role in this area. A failure to conduct additional outreach may lead to the promulgation and application of a misguided standard that can impair the very communications that the PCAOB seeks to stimulate. Accordingly, the CCMC requests that either the comment period be extended, or the proposal be withdrawn for later re-exposure, in order to expand outreach to better understand the realities of the auditor-audit committee dynamic and facilitate the intent of the proposal.

The CCMC's specific concerns are listed below.

I. Enhancing the Auditor-Audit Committee Dialogue

The CCMC agrees that a healthy dialogue between auditors and the audit committee is necessary for effective internal control procedures, external audit functions, management of a company, and long-term value creation for shareholders.

The proposal represents a fundamental shift from the assumption underlying the existing PCAOB interim audit standard (AU Section 380, *Communication with Audit Committees*) which states that audit committee communications are *incidental* to the audit. In contrast, the release text of the proposal states that "[t]he Board considers communications with audit committees to be an integral part of the audit process."[1] We have concerns about the PCAOB's approach to implementing this fundamental change.

Auditor-Audit committee communications are a three sided triangle made up of auditors, management and directors. The PCAOB has jurisdiction over one side of the triangle- auditors, but not over the other two. The responsibilities and duties of management and directors are embedded in state corporate law, federal law, and regulations. Therefore, the PCAOB cannot impact all sides of the triangle and appears to not have taken into account the duties and responsibilities of directors and management.

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[1] ***Proposed Auditing Standard Related to Communications With Audit Committees*** **PCAOB Rulemaking Docket Matter No. 030,** Page 16.

Our comments focus on two new requirements in the proposed standard related to (1) the two-way communication between the auditor and the audit committee and (2) the auditor's evaluation of the quality of the company's financial reporting and disclosures.

II. The Two-Way Communication Between the Auditor and the Audit Committee

One of the Board's primary objectives in proposing a new standard is to "emphasize the importance of effective, two-way communications between the auditor and the audit committee to better achieve the objectives of the audit."[2] The proposal generally provides for written or oral communications, unless otherwise specified. Nonetheless, based on release text, the Board's intent is that the auditor should lead an active two-way discussion with the audit committee and further states that having a robust dialogue on key matters is the most important factor in effective communications with the audit committee.[3]

As stated earlier, the PCAOB has no authority over audit committees and other entities are legally charged with that authority. However, the Board, through the back-door of an auditing standard, is shifting the responsibility from the audit committee to the auditor.

While evaluating the *adequacy* of the two-way communication is the objective, in release text, the PCAOB states that the two-way communication should be *open, active, robust,* and *substantive.*[4] So, notwithstanding the proposed guidance in the standard itself that specifies the basis for the auditor's evaluation of adequacy (pp. A1-13 to 14), the implication is that in order to be adequate the two-way communication must also be open, active, robust, and substantive. Not only do we take issue with this threshold for adequate communications with the audit committee for the purposes of conducting the audit, we are concerned with establishing these thresholds through

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[2] Ibid, Page 3.
[3] Ibid, Page 16
[4] Ibid, Pages 7 and 16

release text rather than the standard itself. We have previously expressed our concern over the use of release text in this way to alter and expand the requirements in an audit standard itself.[5]

Finally, we recognize that the International Standards on Auditing ("ISAs") promulgated by the International Auditing and Assurance Standards Board ("IAASB") similarly require that the auditor evaluate whether the two-way communication with the audit committee has been adequate for the purposes of the audit. However, the IAASB's guidance on the basis for this evaluation is in the section of the ISA on application and other explanatory material. As such, the IAASB's guidance is not intended to impose a requirement. This illustrates a significant difference between the approach to crafting standards taken by the PCAOB and the IAASB that needs to be reconciled. We continue to encourage the PCAOB to make convergence of auditing standards a priority and to take up the leadership mantle in making this goal a reality.[6]

III. The Auditor's Evaluation of the Quality of the Company's Financial Reporting and Disclosures

Currently auditing standards include a requirement for the auditor to *inform* the audit committee about such things as the initial selection of and changes in significant accounting policies or their application and the process used by management in formulating particularly sensitive accounting estimates and judgments. Current auditing standards also require the auditor to discuss with the audit committee the auditor's judgments about the quality, not just the acceptability of the accounting principles applied by management. However, the PCAOB's proposed standard goes well beyond a discussion of these matters and requires the auditor to evaluate them.

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[5] For example, see letter from the United States Chamber of Commerce Center for Capital Markets Competitiveness to the Securities and Exchange Commission ("SEC") on **SEC File Number PCAOB-2009-02,** ***Auditing Standard No. 7 – Engagement Quality Review.***

[6] For example, see letters from the United States Chamber of Commerce's Center for Capital Markets Competitiveness on **PCAOB rulemaking docket matter No. 026,** ***Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk*** (February 18, 2009 and March 2, 1010), on **PCAOB rulemaking docket matter No. 025,** ***Proposed Auditing Standard on Engagement Quality Review,*** and on **SEC File Number PCAOB-2009-02,** ***Auditing Standard No. 7 – Engagement Quality Review.***

In turn, it is the auditor's evaluation that would then be discussed with the audit committee.

For example, the proposal would require the auditor to discuss with the audit committee:

- The auditor's evaluation of the quality, not just the acceptability under the applicable financial reporting framework of significant accounting policies and practices;[7]

- The auditor's evaluation of management's disclosures related to critical accounting policies and practices (in MD&A), along with any significant modifications to these disclosures proposed by the auditor, but not made by management; and

- Alternative treatments permissible under the applicable financial reporting framework for policies and practices related to material items that have been discussed with management, including the ramifications of the use of such alternative treatments and disclosures, and the treatment preferred by the auditor.

Management is responsible for the financial reporting and disclosures. Yet, The PCAOB's proposed requirements set up a dynamic that pushes auditors to use financial reporting policies and practices to impinge on matters that are not only within the purview of management, but is the legal responsibility of management. This will create confusion around financial reporting, adversely impact the management of a company, and blur lines of responsibility, ultimately harming investors.

IV. Auditor Independence and Litigation Risk

The Board's proposal raises significant issues with respect to auditor independence and litigation risk. Assigning the auditor responsibilities for making the

[7] Current standards recognize that objective criteria have not been developed to aid in the consistent evaluation of the quality of a company's accounting principles. The PCAOB's proposed standard deletes this statement without providing any objective criteria for such an evaluation.

financial reporting process and the oversight of that process more effective appears to violate the Securities and Exchange Commission ("SEC") guiding principles on auditor independence. The Board's proposal mandates actions by auditors that have the potential, to create mutual or conflicting interests with audit clients, or put the auditor in the position of acting as management.

These actions could significantly exacerbate litigation risks for auditors. With any adverse outcome, it would open-up auditor judgments on the nature and timing of audit committee communications to second-guessing in private actions and regulatory enforcement. Frankly, it creates what appears to be a strict liability regime for auditors through auditing standards. Furthermore, even without adverse outcomes, it would expand the scope for allegations of audit deficiencies through the Board inspection and enforcement processes over issues that are not central to audit quality or within the scope of responsibility for auditors.

V. Conclusion

The CCMC is concerned that the Board's proposal has the potential to significantly alter the long-standing and well recognized role and responsibilities of the external auditor, management, the board of directors and the audit committee. The Board has no authority over management the audit committee or the board of directors.

Nonetheless, the Board's proposed standard pushes auditors towards becoming responsible for and gatekeepers on the effectiveness of audit committees generally and the board of directors more specifically. In addition, the Board's proposal pushes auditors in the direction of stepping into the shoes of management on matters of financial reporting and disclosures.

While well intentioned, the Board's proposal lacks an understanding of the legal responsibilities and roles of management and directors. Indeed, the proposal goes beyond the bounds of the Board's jurisdictions and responsibilities. Accordingly, the CCMC respectfully requests that the proposal should be withdrawn and reconsidered after sufficient additional outreach to correct these deficiencies.

Sincerely,