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Mr. J. Gordon Seymour
Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, DC 20006-2803

Re: PCAOB *Proposed Auditing Standard Related to Communications with Audit Committees; Related Amendments to PCAOB Standards; and Transitional Amendments to AU SEC. 380* (PCAOB Release No. 2011-008, December 20, 2011 and PCAOB Rulemaking Docket Matter No. 030)

Dear Mr. Seymour:

The U.S. Chamber of Commerce (the "Chamber") is the world's largest federation of businesses and associations, representing the interests of more than three million U.S. businesses and professional organizations of every size and in every economic sector. These members are both users and preparers of financial information. 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 believes that businesses must have a strong system of internal controls and recognizes the vital role external audits play in capital formation. The CCMC supports efforts to improve audit effectiveness. Healthy communications between auditors and audit committees are 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* ("the Proposal").

The CCMC believes that the Proposal is an improvement over the initial draft that had been issued by the PCAOB. However, the CCMC still questions the overall authority of the PCAOB over some aspects of the standard. Additionally, the CCMC still has concerns that the Proposal may in fact degrade audit quality and reduce meaningful communications between the auditor and audit committee. Furthermore, the CCMC believes that more clarity is needed regarding broker-dealers since many do not use a public company business structure. Finally, the CCMC believes that the PCAOB should form a business advisory group to increase the scope of meaningful dialogue before a standard is proposed.

Our concerns are listed in more detail below.

Discussion

The Proposal is the second time that the PCAOB has exposed for public comment a standard on auditor communications with audit committees. The PCAOB's initial draft was proposed on March 29, 2010 ("the initial draft"). The PCAOB received 44 comment letters on the initial draft—a number of which, including the CCMC's,[1] expressed concerns over that proposed guidance. The CCMC requested the PCAOB withdraw the initial proposal for reconsideration and re-exposure. As an essential part of the reconsideration process, the CCMC urged the PCAOB to engage in outreach to better understand the entire dialogue that occurs in the management of a public company and appreciate the realities of the auditor-audit committee dynamic.

The Proposal represents a substantive change from the initial draft. The CCMC applauds the PCAOB for its efforts to address the concerns raised by the CCMC and others and holding a roundtable to solicit greater feedback.

Nonetheless, serious issues remain that need to be addressed before this standard is finalized.

1. Sarbanes-Oxley and the Audit Committee

In passing the Sarbanes Oxley Act of 2002 ("SOX"), Congress granted the PCAOB oversight powers over the audit and auditors, while giving the SEC

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[1] *See* the May 28, 2010 letter from the United States Chamber of Commerce Center for Capital Markets Competitiveness to the PCAOB on *Proposed Auditing Standard Related to Communications with Audit Committees.*

jurisdiction over corporate governance issues including the audit committee. Therefore, as we stated in our comment letter on the initial draft, it would seem that the PCAOB does not have jurisdiction over the audit committee and that the Proposal would seem to infringe upon the prerogative of the SEC to oversee corporate governance issues as mandated under SOX. This has led to a confusion of the proper roles that were established by Congress and could distort both governance and audit oversight. Accordingly, we would recommend that the Proposal be reviewed with this in mind and confined to the appropriate areas of PCAOB oversight.

2. Approach to Auditing Standard Development

The CCMC is concerned about the level of prescriptivness in the Proposal. While the Proposal articulates an objective for audit committee communications, it goes on to require a large number of specific actions of the auditor. To illustrate, the 25-paragraph Proposal contains at least 26 "should"—prescriptive directives—which under the PCAOB's rules are presumptively mandatory responsibilities.[2] In addition, approximately 35 more actions are required of the auditor when counting the items listed under these prescriptive directives. As such, the Proposal can hardly be considered an objective or principles-based standard.

Indeed, the Proposal reads like a rule-book leaving little room for the exercise of judgment and common sense by auditors. While the individual actions required of auditors are not necessarily objectionable, considered as a whole, the Proposal builds a good deal of boilerplate disclosure into auditor-audit committee communications. As a result, the Proposal engenders what can be called a "check-the-box" compliance mentality to auditor communication. Such a result does not promote audit quality and in fact compromises fluid free flowing communications between the auditor and audit committee.

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[2] PCAOB Rule 3101 on *Certain Terms Used in Auditing and Related Professional Practice Standards* states: "The word 'should' indicates responsibilities that are presumptively mandatory. The auditor must comply with requirements of this type … unless the auditor demonstrates that alternative actions he or she followed in the circumstances were sufficient to achieve the objectives of the standard." The rule contemplates that alternative actions would be rare. However, "[i]f a Board standard provides that the auditor 'should consider' an action or procedure, consideration of the action or procedure is presumptively mandatory, while the action or procedure is not."

In addition, the CCMC is concerned that the PCAOB is embarking on this prescriptive approach to bulk up on inspection metrics. If so, this seems a short-sighted convenience that may be sacrificing overall audit quality for a "gotcha" system of regulation. Moreover, it is not obvious that rules-based auditing standards are necessary for the efficacy of an inspection process.

All things considered, it is questionable whether investors are being well served by the PCAOB's current approach to audit standards development. Given that the issue is central to audit quality, the CCMC recommends that the PCAOB's prescriptive approach to writing auditing standards be added to the agenda of the PCAOB's Standing Advisory Group ("SAG") for a fulsome discussion of its usefulness and limitations in an open and transparent manner. Indeed, we believe that this should also be the subject of discussion of a business advisory group that will be discussed later in this letter.

3. Use of Release Text

The CCMC is concerned, as we have written before,[3] that release text is being used to modify the standard and provide guidance and interpretations not found in the standard itself. The following examples from the Proposal illustrate this concern:

- **Obtaining Information Relevant to the Audit**

The proposed standard states in part:

> *The auditor should inquire of the audit committee whether it is aware of matters that might be relevant to the audit, including, but not limited to, knowledge of violations or possible violations of laws or regulations and complaints or concerns raised regarding financial reporting matters.*[4]

On the other hand, in discussing this requirement, the release text gives "strategic decisions that might significantly affect the nature, timing, and extent of

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[3] For example, see the March 2, 2010 letter from the United States Chamber of Commerce Center for Capital Markets Competitiveness to the PCAOB on the *Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk* (PCAOB Rulemaking Docket Matter No. 026).
[4] PCAOB Release No. 2011-008, December 20, 2011, Paragraph 8.

audit procedures" as an example of matters that audit committees might be aware of that might be relevant to the auditor in planning and performing audit procedures.[5] This example should be included in the standard if it is indeed the PCAOB's intent that the auditor should include it in inquiries of the audit committee.

- **Auditor's Evaluation of the Quality of the Company's Financial Reporting**

In the section of the proposed standard on the auditor's evaluation of the quality of the company's financial reporting, the matters listed that the auditor should communicate to the audit committee include:

> *New accounting pronouncements. Situations in which, as a result of the auditor's procedures, the auditor identified a concern regarding management's anticipate application of accounting pronouncements that have been issued but not yet effective and might have a significant effect on future financial reporting.*[6]

It would be natural to conclude that this communication requirement is around the "quality" of the company's disclosures related to new accounting pronouncements. However, the release text explains that "[t]he auditor might be concerned about changes to accounting or disclosure processes, or systems that could affect financial reporting or whether management has devoted adequate resources to the pending adoption. Requiring the timely discussion of such matters is intended to allow time for the audit committee to properly consider the effects on future financial statements".[7] If the PCAOB intends that this audit committee communication address operational matters and internal controls over financial reporting, then the PCAOB should so state in the standard itself because a reasonable reading of the proposed standard does not reveal this intent.

- **Disagreements with Management**

The proposed standard states:

[5] Ibid, Appendix 4, Page A4-7.
[6] Ibid, Paragraph 13(f)
[7] Ibid, Appendix 4, Page A4-29

> *The auditor should communicate to the audit committee any disagreements with management about matters, whether or not satisfactorily resolved, that individually or in the aggregate could be significant to the company's financial statements or the auditor's report.*[8]

The release text explains that the Proposal retains the requirement from AU Sec. 380.13. However, the release text goes on to provide examples of disagreements that are part of AU Sec. 380.13 but not included in the proposed standard. In other words, the Proposal deletes the examples from the standard and moves them to release text.[9] It is not clear why the PCAOB has made this alteration, although perhaps it is because the examples use the word "might," which under PCAOB Rule 3101 invokes a responsibility for the auditor to consider rather than a presumptively mandatory responsibility. If so, this likewise reinforces the CCMC's previously expressed concern about the prescriptive approach the PCAOB is taking to writing auditing standards.

The CCMC recognizes that release text has merit, particularly in exposure drafts of proposed standards, as it can facilitate better public input. Nonetheless, since release text in any final standard will be referenced by plaintiff attorneys, PCAOB inspectors, and other regulators as a touchstone for the PCAOB's intent, we encourage the PCAOB to be very cautious and transparent in crafting release text for adopting standards.

4. Appropriately Recognizing Management's Responsibilities

The CCMC's comment letter to the PCAOB's initial draft emphasized that auditor-audit committee communications are part of a three-sided triangle made up of auditors, management, and directors. The Proposal represents a significant improvement over the initial draft in appreciating the respective roles and responsibilities of each of the three parties in the triangle.

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[8] Ibid, Paragraph 21.

[9] Ibid, Appendix 4, Page A4-38. The release text states: "Examples of disagreements might include disagreement with management about the application of accounting principles to the company's specific transactions and events and the basis for management's judgments about accounting estimates. Disagreements might also arise regarding the scope of the audit, disclosures to be made in the company's financial statements, or the wording of the auditor's report."

Nonetheless, in some areas, the Proposal fails to appropriately recognize that management has the primary responsibility for financial reporting. Accordingly, management has the primary responsibility for initiating communications with the audit committee related to this responsibility, which includes communications on significant accounting policies and practices and critical accounting policies, practices, and estimates. For example, the Proposal includes requirements for the *auditor* to communicate to the audit committee a number of matters regarding accounting policies, practices, and estimates that are in reality the management's responsibility,[10] and therefore it is management's responsibility to initiate communications with audit committees on these matters.

The proposed standard does contain a note that recognizes some or all of the matters required to be communicated by the auditor *might* be communicated by management.[11] And, if so, the auditor does not need to communicate them at the same level of detail as management. Unfortunately, the standard goes on to say that this holds only so "long as the auditor (1) participated in management's discussion with the audit committee, (2) affirmatively confirmed to the audit committee that management has adequately communicated these matters, and (3) identified for the audit committee those accounting policies and practices that the auditor considers critical".[12] As such, the Proposal appears to be creating a financial reporting partnership between management and the auditor that blurs a responsibility that is primarily management's. In addition, it will result in duplicate communications to the audit committee and exacerbate the use of non-communicative boilerplate language in communications from auditors.

Furthermore, the proposed requirements regarding auditor communications of significant accounting policies and practices <u>and of critical accounting policies and practices</u> lack clarity.[13] For example, it is not clear if the intent is to have the auditor communicate to the audit committee *each year* management's significant accounting policies and practices or only changes in such policies or their application. If the former, this will lead to more boilerplate disclosures that are of little use to investors. <u>In regards to critical accounting policies and practices, it is unclear what disclosures</u>

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[10] Ibid, Paragraph 12
[11] Ibid, Appendix 1, Page A1-8
[12] Ibid.
[13] Ibid, Paragraph 12.a and 12.b

the PCAOB has in mind; as such disclosures are not required by generally accepted accounting principles ("GAAP") but rather in management's discussion and analysis. Thus, it appears the PCAOB may be asking the auditor to assess disclosures within the GAAP notes to the financial statements that management does not necessarily have a responsibility to provide.

5. **Other Matters**

The Proposal includes a requirement that "[t]he auditor should communicate to the audit committee other matters arising from the audit that are significant to the oversight of the company's financial reporting process. This communication includes complaints or concerns regarding accounting or auditing matters that have come to the auditor's attention during the audit and the results of the auditor's procedures regarding such matters".[14]

More clarity around this requirement seems necessary. For example, public statements by PCAOB board members have suggested that PCAOB auditing standards should require auditors to communicate to the audit committee PCAOB inspection findings and any necessary remediation by the auditor. If this type of communication is what the PCAOB intends by this "catch-all" paragraph, this intent should be clearly stated and limited to the extent such findings and remediation relate to the company's audit engagement.

6. **Brokers and Dealers**

Since the issuance of the initial exposure draft, the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") has given the PCAOB oversight of the audits of brokers and dealers registered with the Securities and Exchange Commission ("SEC"). The SEC has proposed to amend its rules to require that audits of the financial statements of brokers and dealers be performed under PCAOB standards. If so, the Proposal would apply to audits of broker dealers. However, the CCMC is concerned that the PCAOB may not fully understand the governance structures and complexities that can occur in brokers and dealers and,

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[14] Ibid, Paragraph 23.

accordingly, whether the proposed requirements will realistically work for these organizations.

For example, the Proposal acknowledges that some brokers and dealers may have governance structures that do not include boards of directors or audit committees. In these circumstances, for non-public brokers and dealers, the Proposal would extend the definition of audit committees to include those persons designated to oversee the accounting and financial reporting processes of the company and its financial statement audit. The CCMC suggests that the PCAOB provide more clarity on the oversight level intended. In doing so, the CCMC recommends that the designated persons not be a CFO or similar officer, but, but rather a chief executive officer. Further, in these circumstances would all the requirements in the Proposal really make sense and apply?

This seems to be an area where a proposed standard may clash with the reality of differing business models that the PCAOB has not contemplated.

Another example is the circumstances that can occur in investment company complexes ("ICC") where issuers (with audit committees) that have investment houses (with audit committees) that are parents for broker dealer subsidiaries that have no audit committees. Perhaps it would be worthwhile for the PCAOB to clarify that the intended communications go to the audit committee of the parent of the broker dealer subsidiary, and not to the audit committee of the issuer or to both.

7. Business Advisory Group

The CCMC respectfully recommends that the PCAOB form a business advisory group consistent with the recommendation of The Financial Instruments Reporting and Convergence Alliance ("FIRCA").[15]

Often the business community is not consulted or input solicited, in the early stages of standard development, to the detriment of development of high quality audit standards.

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[15] *See* February 23, 2012 letter from The Financial Instruments Reporting and Convergence Alliance to the Honorable James Doty, Chairman of the Public Company Accounting Oversight Board.

If the PCAOB had a business advisory group, it could have consulted with them and received input early in the process to understand the business and audit committee concerns with an issue. In this instance, such communication may have lead to a differently tailored Proposal all together. Consequently, a business advisory group could also be an important resource for the PCAOB on many other issues as well. The formation of a business advisory group will allow for a more consistent means for the PCAOB to consult on issues as it develops priorities and moves forward on them.

Following the fair value debate in 2008-2009, the Financial Accounting Foundation and Financial Accounting Standards Board have dramatically increased business input and communications. This has led to a better means of standard development during the difficult convergence process. We would recommend that the PCAOB follow this example.

Conclusion

The CCMC reiterates its acknowledgement of the improvements that the PCAOB has made in the Proposal. Some of these improvements result from the PCAOB's outreach activities, such as a roundtable, to better understand the entire dialogue that occurs in the management of a public company. However, the fact that much of this outreach was done subsequent to the release of the initial exposure draft reinforces a CCMC concern that there is an insufficient level of input from the business community on auditing proposals. While we believe that roundtables are an important means of developing input, they are also done on an ad-hoc basis.

The CCMC believes that standard setters should have a wide range of input to ensure the proper consideration of business operations and potential unintended consequences in the development and implementation of accounting and auditing standards. An insular approach may cause the PCAOB to expend resources that may best be allocated elsewhere, while developing standards that do not provide for adequate financial reporting structures to convey decision useful information to investors or businesses.

Accordingly, we request that the PCAOB review the Proposal to address the concerns outlined in this letter. Thank you for your consideration and the CCMC stands ready to assist in these efforts.

Sincerely,

Tom Quaadman