



via e-mail to: comments@pcaobus.org

May 30, 2012

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

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

Ladies and Gentlemen:

The Society of Corporate Secretaries and Governance Professionals (the “Society”) appreciates the opportunity to provide comments on the 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, issued on December 20, 2011 (the “Release”) by the Public Company Accounting Oversight Board (the “PCAOB”).

Founded in 1946, the Society is a professional membership association of more than 3,000 corporate secretaries, in-house counsel and other governance professionals who serve approximately 2,000 companies of almost every size and industry. Society members are responsible for supporting the work of corporate boards of directors and their committees and the executive managements of their companies regarding corporate governance and disclosure. Our members generally are responsible for their companies’ compliance with the securities laws and regulations, corporate law, and stock exchange listing requirements.

The Society appreciates the PCAOB’s efforts to “benefit investors by establishing requirements that enhance the relevance and quality of the communications between the auditor and the audit committee,”¹ and we support the PCAOB’s efforts to “encourage effective two-way communications between the auditor and the audit committee throughout the audit to assist in understanding matters *relevant* to the audit.”² However, we believe that, due to rules adopted under the Sarbanes-Oxley Act of 2002 as well as leading practices, management and audit committees generally keep auditors well informed of developments. The Society therefore believes that the following proposed standard (the “Proposed Standard”) is not needed and, if adopted, would not be helpful and indeed could be harmful to companies and their investors, and counterproductive to the stated objectives of the Release, as discussed below.

¹ Release at 2.

² Release at 3 (emphasis added).

“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.”³

The Proposed Standard Is Overbroad and Overreaching

The Society believes that the Proposed Standard is too broad and overreaching. The Proposed Standard would require the auditor to inquire of the audit committee whether it is aware of matters that *might be* relevant to the audit. The fact that the Release repeatedly discusses the Proposed Standard in terms of actual relevance⁴ to the audit is misleading because the scope of the auditor’s inquiry of the audit committee under the Proposed Standard is much broader and would cover matters that are not only actually relevant, but also merely potentially relevant, to the audit.

We are concerned that the Proposed Standard would effectively impose an obligation on the audit committee to disclose to the auditors *all* matters related to the company’s business, including *all* reports of violations or *possible* violations of laws or regulations by the company, as well as complaints or concerns raised by *any* person within the company or by *any* third-party. In response to the auditor’s inquiry, members of the audit committee would appear to be compelled to discuss with the auditor all information, without any materiality or probability threshold,⁵ that they receive from management, employees or third parties, simply due to the fact that the audit committee would be unable to conclude with any certainty that there is no chance that, in hindsight, any particular report or complaint of a potential violation of law or other matter will not have been deemed of potential relevance to the audit. The Proposed Standard would require disclosure of such reports or complaints even before they have been thoughtfully considered, evaluated, probed or properly investigated by the company. In addition, due to the breadth of the Proposed Standard, the abundance of information that the audit committee would be required to disclose in order to be responsive to the auditor’s inquiry may also have the effect of obscuring material information that is truly relevant to the audit.

³ Release at A1-3.

⁴ The following statements in the Release imply that the Proposed Standard covers only matters actually relevant to the audit: “[t]he new proposed standard improves and enhances current auditor communication requirements by: ...[e]nhancing the auditor’s inquiries of the audit committee regarding matters *relevant* to the audit;” “[a]s described in the new proposed standard, the term, ‘communicate to’ is meant to encourage effective two-way communications between the auditor and the audit committee throughout the audit to assist in understanding matters *relevant* to the audit;” “[t]his standard requires the auditor to communicate certain matters related to the conduct of an audit to a company’s audit committee and to obtain certain information from the audit committee *relevant* to the audit;” under the subheading in the Release “Obtaining Information *Related* to the Audit”: “[a]dditionally, complaints or concerns may come to the audit committee’s attention through the audit committee’s process for reporting ethics violations or concerns related to financial reporting that are *relevant* to the audit.” Release at 7, 3, A1-1, A4-7 (emphasis added).

⁵ The Society acknowledges existing Paragraph 56.b.(3) of Auditing Standard No. 12, which requires the auditor to inquire of the audit committee, or equivalent, or its chair, in connection with the auditor’s obligations to identify and assess the risks of material misstatements and associated inquiries regarding fraud risks, whether the audit committee is aware of tips or complaints regarding the company’s financial reporting (including those received through the audit committee’s internal whistleblower program) and, if so, the audit committee’s responses to such tips and complaints. However, unlike the breadth of information that the audit committee would be compelled to divulge to the auditor pursuant to the Proposed Standard, existing Auditing Standard No.12 inherently contains probability and materiality thresholds, in that tips or complaints regarding the company’s financial reporting are in fact relevant to the audit and thus also may, upon further inquiry as to scope, be material.

The Proposed Standard Would Confuse the Roles of the Audit Committee and Management

The Society believes that the Proposed Standard, if adopted, would fundamentally change the role of the audit committee from overseeing the accounting and financial reporting processes of the company and audits of financial statements of the company to becoming one of the original sources of information for the auditors. Ultimately, the implementation of the Proposed Standard may undermine management's responsibility for the financial statements and related disclosures and result in a confusion of the roles of the audit committee and management. Management is responsible for the preparation of the financial statements and related disclosures, and information relevant to the audit should be obtained through auditor's discussions with the management and management's representations to the auditors. The Proposed Standard, however, appears to effectively make the audit committee a guarantor of the accuracy and completeness of the financial statements and notes to financial statements, which has historically been management's, and not the audit committee's, responsibility.

The Proposed Standard Could Jeopardize the Attorney-Client Privilege and Work Product Protection and Threaten Sensitive Company Information

If the Proposed Standard is adopted and the audit committee is effectively forced to share with the auditor all of the information in its possession communicated from management, employees and others concerning potential violations and other matters, such information could be mishandled to the detriment of the company. The Proposed Standard indicates that the information provided to the auditors as a result of their inquiries to the audit committee may cause the auditor to adjust its planned audit procedures.⁶ It would appear that the auditors, rather than the proper company personnel after thoughtful and careful evaluation of the information by the audit committee, Chief Compliance Officer or other authorized person(s), might in effect be deputized to conduct investigatory procedures via the audit process concerning matters that the audit committee may have not been prepared to communicate outwardly at all, and has not yet had an opportunity to properly evaluate. Directors have a fiduciary obligation to maintain company information in confidence (ordinarily deemed to be a component of the duty of loyalty), whereas auditors do not have such fiduciary duty. It would appear that all such information could lose its confidentiality status (whether incorporated into the auditor's work papers or not) with potentially significant harmful consequences to the company.

Similarly, the Proposed Standard appears to require the audit committee to disclose to the auditor violations or possible violations of laws or regulations and complaints or concerns raised regarding financial reporting matters, including matters that can be investigated or litigated at the time of such disclosure. Such matters are typically "led by [in-house and outside] legal counsel and [result] in an accumulation of attorney-client communications, witness interviews, advice of counsel and other legal work product and analyses."⁷ Attorney-client privilege encourages full and frank communications between attorneys and their clients and protects communications between attorneys and their clients. The related attorney work product doctrine prevents from production materials that disclose the

⁶ The Release states that "[t]he new proposed standard does not provide specific timing for these inquiries [of the audit committee] to be made; however, information provided by the audit committee could require the auditor to adjust planned audit procedures. Therefore, performing these inquiries early in the audit process would enable the auditor to incorporate the information received from the audit committee into the audit strategy." (pp. A4-7, 8)

⁷ *The Auditor's Need for its Client's Detailed Information vs. the Client's Need to Preserve the Attorney-Client Privilege and Work Product Protection: the Debate, the Problems, and Proposed Solutions* at 4 (Dec. 22, 2004).

attorney's theory or strategy regarding anticipated or pending litigation and protects the lawyer's analysis and views on litigation and potential litigation.

If the audit committee discloses privileged attorney-client communications or attorney work product to the auditor, the company may face a very substantial and serious risk that a court may later deem that such disclosures effectively waived the protections of attorney-client privilege and work product doctrine. If materials disclosed by the audit committee to the auditor become discoverable by the court due to the waiver of a privilege, it could well change the outcome of litigation and disadvantage the company's ability to win and/or negotiate a settlement negotiations, at the expense of shareholders. In the absence of consistent and uniform court decisions, companies have no guarantee that courts will protect attorney-client communication and attorney work product "from waiver as to the companies' adversaries if these materials are disclosed to auditors."⁸ In addition, "companies that seek the assistance of legal counsel would only do so in the face of an unacceptable risk that counsel will be converted 'into a conduit of information between the client' and its adversaries."⁹

The Proposed Standard May Shift Oversight Responsibility for the Company's Corporate Compliance to the Auditor and May Harm the Company's Compliance Program

The Society believes that the Proposed Standard could harm a company's compliance program. Investors benefit from effective compliance programs that encourage and promote good faith reports of violations and suspected violations of laws and other compliance concerns. Such compliance programs are often tied to codes of ethics or conduct under existing SEC regulations and stock exchange requirements that require, among other things, the inclusion of standards to promote and encourage internal reporting of suspected or known misconduct to appropriate company personnel. In addition, under applicable exchange listing requirements, audit committees are charged with establishing procedures for: (i) the receipt, retention, and treatment of complaints regarding accounting, internal accounting controls, or auditing matters; and (ii) the *confidential*, anonymous submission by employees of such company of concerns regarding questionable accounting or auditing matters.¹⁰

Delaware case law, the Federal Sentencing Guidelines as well as the Sarbanes-Oxley Act, the Dodd-Frank Act and SEC rules promulgated under these acts emphasize that the board of directors, and often the audit committee in particular, should oversee the establishment and implementation of a corporate compliance program (of which the code of ethics/conduct discussed above is deemed an integral part) designed to detect corporate wrongdoing. An important part of the board's fiduciary oversight responsibility is its ability to exercise independent judgment as to how, when, what and to whom matters should be communicated, and how such matters should be handled.

The Proposed Standard, due to its breadth, may effectively eliminate the ability of the audit committee or the board to exercise independent judgment in this regard. It thus could compromise the audit committee's oversight responsibility and make it a mere conduit between management/employees and the auditor for suspected or known misconduct communicated (often with a legitimate expectation of confidentiality) to it by management and employees. The fact that the audit committee will be compelled to disclose all such information, without any materiality or probability threshold, that it

⁸ Id. at 6.

⁹ Id. at 6.

¹⁰ See Rule 10A-3 promulgated under the Securities Exchange Act of 1934, as amended (emphasis added).

receives from management, employees or third parties, to the auditors (in many cases prematurely), who lack the fiduciary duties that the directors owe to the company and its shareholders, effectively shifts the audit committee's oversight role to the auditors. The Society believes that such shift is inappropriate and threatens to obstruct the objectives of the company's compliance efforts and the audit committee's oversight responsibilities.

In addition, critical to a company's efforts to promote and encourage internal reporting is assuring employees that they may report suspect and known violations in confidence and without fear of retaliation. The company's efforts to encourage and promote good faith reports of violations and suspected violations of laws and other compliance concerns may be compromised if employees believe that any information they share with the audit committee, will be communicated to the auditors, either directly or indirectly. The Proposed Standard would have the unintended effect of reducing candor and chilling communications between management and other employees and the audit committee regarding concerns and complaints related to potential violations and other compliance matters, thus reducing the availability of such information and impeding the effectiveness of the company's compliance program.

For all of these reasons, the Society does not support the Proposed Standard discussed in the Release.

We thank the PCAOB for its efforts to "enhance the relevance and quality of the communications between the auditor and the audit committee,"¹¹ and we would be happy to provide you with further information to the extent you would find it useful.

Respectfully submitted,

The Society of Corporate Secretaries and Governance Professionals

A handwritten signature in black ink, appearing to be 'R. Lamm', with a large loop at the start and a horizontal line at the end.

Robert B. Lamm,
Chair, Securities Law Committee

cc: James R. Doty
Lewis H. Ferguson
Daniel L. Goelzer
Jay D. Hanson
Steven B. Harris

¹¹ Release at 2.