CENTER FOR CAPITAL MARKETS
COMPETITIVENESS

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December 9, 2013

Ms. Phoebe W. Brown
Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006

Re: PCAOB *Proposed Auditing Standards – The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion; The Auditor's Responsibilities Regarding Other Information in Certain Documents Containing Audited Financial Statements and the Related Auditor's Report; and Related Amendments to PCAOB Standards* (PCAOB Release No. 2013-005, August 13, 2013; PCAOB Rulemaking Docket Matter No. 034)

Dear Ms. Brown:

The U.S. Chamber of Commerce (the "Chamber") is the world's largest federation, 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 and appreciates the opportunity to comment on the Public Company Accounting Oversight Board ("PCAOB") *Proposed Auditing Standards—The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion and The Auditor's Responsibilities Regarding Other Information in Certain Documents Containing Audited Financial Statements and the Related Auditor's Report* ("the Proposal").

Rather than informing investors and financial statement users, the Proposal may create a tower of Babel that can sow confusion in a marketplace that SEC Chair Mary Jo White has acknowledged already suffers from "disclosure overload."[1] The CCMC is concerned that the Proposal does not address investor needs, causes investor confusion by creating overlap and competition with other regulatory mandates, increases financial reporting complexity and blurs the lines of responsibilities between auditors and businesses. This will degrade audit quality and hamper the utility of financial reports for users and issuers thereby making the capital markets less efficient.

Accordingly, the CCMC believes that the Proposal does not meet minimum thresholds required to move forward. Instead, the CCMC respectfully requests the PCAOB should work with the Securities and Exchange Commission ("SEC") and Financial Accounting Standards Board ("FASB") to move forward on a broad agenda of financial reporting modernization as outlined in the CCMC's letter October 9, 2013 to SEC Chair Mary Jo White.

Our concerns are discussed in greater detail below.

Discussion

The PCAOB issued a Concept Release on possible revisions to the auditor's report in June 2011 and received 155 comment letters. The CCMC provided comments on the Concept Release expressing serious concerns in a comment letter filed with the PCAOB.[2] We continue to have the same concerns regarding the Proposal, and accordingly, have attached the September 14, 2011 letter. At the same time the PCAOB also issued a Concept Release on Auditor Independence, and the CCMC responded by filing a comment letter on October 20, 2011.[3] As we continue

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[1] *See* October 15, 2013 speech of SEC Chairman Mary Jo White, *The Path Forward on Disclosure*, before the National Association of Corporate Directors.

[2] *See* the September 14, 2011 letter from the United States Chamber of Commerce Center for Capital Markets Competitiveness on the PCAOB *Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements and Related amendments to PCAOB Standards* (PCAOB Release No. 2011-003, June 21, 2011, Rulemaking Docket Matter No. 034).

[3] *See* October 20, 2011 letter from the United States Chamber of Commerce Center for Capital Markets Competitivness on the PCAOB *Concept Request for Public Comment on Concept Release on Auditor Independence and Audit Firm Rotation and Notice of Roundtable (PCAOB Release No. 2011-006, August 16, 2011, PCAOB Rulemaking Docket Matter No. 37)*

to have some of the same concerns on the Proposal's stance on auditor independence, we have also attached the October 20, 2011 comment letter. We respectfully request that these attachments be included as a part of the Proposal comment file.

I. Investor Concerns

While we recognize that the PCAOB has engaged in outreach activities since the Concept Release, we are concerned that the PCAOB has not defined the investor need it is attempting to address, what investors it has consulted, and if the outreach has included a broad representative sample of the investor community. A failure to articulate specific investor needs and transparently identify the investor consultations undertaken to develop the Proposal undermines the fairness of the process, composition of the Proposal, and the need to move forward.

The CCMC believes that the articulation of investor needs and transparency of outreach in the development of the Proposal is a minimum necessary threshold for moving forward. This is particularly true since the Proposal fundamentally changes the Audit report and the role of the auditor.

The CCMC believes that these threshold requirements for moving forward with the Proposal have not been met.

II. Alternatives to the Proposal

The Proposal would significantly change the role and responsibilities of the auditor and represent the most significant changes to auditor reporting in more than 70 years. In our September 14, 2011 comment letter, we emphasized the need to address the threshold question of whether the PCAOB should engage in such a sweeping standard-setting initiative. This threshold question still needs to be addressed with this Proposal. Simply put, why is the PCAOB proposing to fix an auditor reporting model that is not broken?

Addressing the threshold question is especially important given that the PCAOB has heard strong support from all stakeholders for retaining the current "pass-fail" model of auditor reporting. The Proposal appears to retain this model with additive reporting requirements. However, auditor reporting of CAMs essentially turns the auditor's report into a graded model.

Accordingly, the CCMC believes the PCAOB should work with the SEC and FASB to move forward on a broad agenda of financial reporting modernization as outlined in the CCMC's letter October 9, 2013 to SEC Chair Mary Jo White.[4] We would be happy to meet with the PCAOB board members to discuss these ideas further.

III. Background of Proposal

The Proposal would require the following:

- A new section in the auditor's report describing critical audit matters ("CAMs");

- New auditor responsibilities for and reporting on other information ("OI") that include requirements to read and evaluate OI, describe the auditor's responsibilities for OI in the auditor's report and state whether the OI contains a material inconsistency, a material misstatement of fact, or both; and

- New language in the auditor's report regarding auditor tenure, auditor independence, and auditor responsibilities related to fraud and the notes to the financial statements.

The CCMC appreciates that the PCAOB has not proceeded with Auditor Discussion and Analysis ("AD&A") as articulated in the Concept Release. Unfortunately, CAMs appear substantively similar to AD&A, notwithstanding that CAMs are described as being grounded in auditing rather than financial reporting matters. Importantly, both CAMs and AD&A overturn the fundamental precepts of financial reporting, as explained below.

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[4] *See* October 5, 2012 letter from the CCMC to the PCAOB, *Information for Audit Committees about the PCAOB Inspection Process* (PCAOB Release No. 2012-003, August 1, 2012) and October 9, 2013 letter from the CCMC to SEC Chair Mary Jo White on financial reporting modernization

IV. Auditor Reporting on Critical Audit Matters ("CAMs")

The Proposal defines CAMs as:

- Those matters that involved the most difficult, subjective, or complex auditor judgments;

- Those matters that posed the most difficulty to the auditor in obtaining sufficient appropriate evidence; or posed the most difficulty to the auditor in forming an opinion on the financial statements; and[5]

- Further, the Proposal would require that the auditor's report identify the specific CAMs, describe the considerations that led to each matter being considered a CAM, and refer to the related financial statement accounts and disclosures in the financial statements (if applicable).

As we discussed in our letter of September 14, 2011, financial statements and disclosures are the responsibility of management. This fundamental premise also extends to OI outside the financial statements such as Management's Discussion & Analysis ("MD&A") and proxy statements—both of which management prepares in accordance with SEC requirements. In turn, the board of directors, largely through the audit committee, exercises oversight of management's reporting and disclosures. The independent audit firm's responsibility is to express an opinion as to whether the company's annual financial statements, including the notes thereto, are presented fairly, in all material respects, in conformity with generally accepted accounting principles ("GAAP").

An essential element of the fundamental premise of financial reporting is that the auditor is not an original source of information about the company. In fact, the auditor is subject to both legal and ethical requirements on confidentiality that preclude this from occurring except in certain specific circumstances. Notwithstanding these core principles, the requirement in the Proposal for the auditor to report CAMs can put the auditor in the position of stepping into the shoes of

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[5] In addition, the Proposal lists a number of other factors that the auditor should take into accounting in determining whether a matter is a CAM (see paragraph 9 (pages A1-7 to A1-8) of the Proposal).

management, becoming an original source of information, and disclosing otherwise confidential information.

Furthermore, CAMs can require auditors to report on matters that management is not required to include or otherwise disclose in the GAAP financial statements, footnotes, or elsewhere, such as MD&A. If the Proposal is approved, management and auditors could be forced to make such disclosures, including disclosing information that would not be considered material by a reasonable and prudent investor. Thus, in multiple ways, the Proposal overturns the fundamental premise of financial reporting and corporate governance disclosures.

The PCAOB's proposed auditor reporting on CAMs also undermines the financial reporting and disclosure frameworks of the SEC and FASB. As the Proposal is currently drafted, CAMs can necessitate auditors disclosing matters that the SEC or FASB has specifically decided that companies are *not* required to disclose. If the SEC has decided that certain information is not useful for investors, thereby not meeting the threshold for disclosure, as a matter of public policy the PCAOB cannot override the SEC's decision.

Examples of this conflict include matters such as weaknesses in internal control over financial reporting ("ICFR") that were appropriately determined to be significant control deficiencies, considerations of going concern that were appropriately addressed by mitigating factors, contingent liabilities that were fully considered and appropriately found not to require disclosure, etc.

The potential to undermine the SEC and FASB reporting and disclosure requirements also occurs because the Proposal appears to preclude the auditor from referencing OI disclosed by management, including OI in MD&A. To illustrate, the Proposal states that "for each critical audit matter communicated in the auditor's report the auditor must … refer to the relevant *financial statement accounts and disclosures* that relate to the critical audit matter, *when applicable*" (emphasize added).[6] In other words, it appears that the Proposal limits the auditor's reference to information in the GAAP financial statements and footnotes covered by the auditor's opinion. Such a limitation would also exacerbate financial reporting complexity.

[6] *See* paragraph 11 of the Proposal (pages A1-8 to A1-9).

The Proposal provides illustrative examples of CAMs and auditor reporting thereon.[7] These illustrations are instructive. For example, among other issues, the examples suggest that investors and other users may interpret the disclosure of CAMs consistent with the auditor providing differential (lesser) assurance on some aspects of the financial statements and notes or otherwise equivocating on providing assurance on the financial statements (including GAAP notes) as a whole. This consequence appears likely notwithstanding statements in the Proposal that it is not appropriate for the auditor to use language that could be viewed as disclaiming, qualifying, restricting, or minimizing the auditor's responsibility for CAMs.[8]

Other problematic aspects of the Proposal in regards to CAMs include the following:

- CAMs would require the auditor to report on matters that were adequately and appropriately disclosed by management. In turn, this will likewise unnecessarily add to financial reporting complexity. It also raises the essential question of the usefulness of this information to investors and other financial statement users. The illustrative examples of CAMs included in the Proposal only reinforce this point.

- On the other hand, circumstances will arise when CAMs lack clarity and/or raise questions and there is no mechanism or venue for the auditor to respond. Again, confidentiality restrictions will likewise constrain the auditor. As a result, this puts the company and management in the position of having to explain (after the fact and in compliance with Reg FD) what the auditor meant.

- CAMs elevate for public disclosure matters that were fully addressed and resolved to the auditor's satisfaction before the audit report was issued.

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[7] *See* pages A5-65 through A5-78 of the Proposal.
[8] *See* the note following paragraph 11(c) (page A1-9) of the Proposal.

- CAMs are not limited to or grounded in matters communicated to or discussed with the audit committee.[9] On the one hand, it is difficult to fathom how a matter could be important enough to disclose to investors but not among those discussed with the audit committee—whether as part of required auditor communications or otherwise. On the other hand, it makes the list of potential CAMs vague, open-ended, and subject to second-guessing.

- It cannot be ruled out that mandating the disclosure of CAMs will have a chilling effect on the normal communication processes between the auditor and management and audit committees. For example, management and/or the audit committee may be more cautious and less open and/or timely in their discussions with auditors to avoid having a matter unnecessarily becoming elevated to a CAM.

- The potential for second-guessing of the auditor's determination of CAMs via PCAOB inspections, regulatory enforcement actions, and private securities actions is also exacerbated by other requirements in the Proposal. For example, the Proposal would require the auditor to document the basis for the determination that each reported matter was a CAM *and* to document the basis for determining that *non-reported* audit matters addressed in the audit, which would appear to meet the definition of a CAM, were not critical audit matters.[10]

- Auditor reporting on CAMs involves some practical considerations, including creating potential impediments to timely SEC filings by companies. Perhaps, on average, auditors will identify CAMs well in advance of SEC filing deadlines and resolve all necessary issues with the company in this regard. Nonetheless, circumstances will arise

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[9] In this regard, the PCAOB's Proposal is unlike the guidance on auditor reporting of key audit matters (KAMs) in the exposure draft of the International Auditing and Assurance Board ("IAASB") on *Reporting on Audited Financial Statements*. The Proposal states that CAMs *ordinarily* are matters required to be documented in the engagement completion document, reviewed by the engagement quality reviewer, communicated to the audit committee, or any combination thereof (see paragraph 8 (pages A1-6 to A1-7) of the Proposal.
[10] *See* paragraph 14 (page A1-10) of the Proposal.

when this is not the case; and so, the likelihood that the Proposal will result in situations where auditor reporting of CAMs delays the timely filing of information by companies cannot be ruled out.

- The audit committee represents investors and the audit committee has the responsibility under the Sarbanes-Oxley Act of 2002 ("SOX") for oversight and monitoring of the external audit. The implication of this SOX mandate is that actionable elements of issues involving CAMs would come under the purview of the audit committee. Furthermore, the Proposal fails to appreciate that the PCAOB has only recently issued new guidance on auditor communications with audit committees.[11] The Proposal does not give adequate time for this new guidance to be implemented and assessed through post-implementation review. The PCAOB should let the audit committee communication process work before considering any external communications by auditors.

- The reporting of CAMs is unlikely to be a "free-writing" exercise at the engagement level. A number of forces, including legal forces will necessitate consistency in the drafting of CAMs over time and across companies. Thus, the likelihood is very high that this initiative would result in auditor reporting that is simply boilerplate.

- The PCAOB expects that CAMs will be disclosed for most audits. Given the heterogeneity in the circumstances of an audit, this expectation may be misplaced. For example, some audits are less complex and more straight-forward.

- Furthermore, investors and other users may make inappropriate inferences about the quality of a company's financial reporting and the nature of the audit based on the number of CAMs disclosed. For example, a "large" number of CAMs may be interpreted as consistent with a contentious audit. On the other hand, very few, if any, CAMs

[11] *See* PCAOB Auditing Standard No. 16, *Communications with Audit Committees*, effective for audits of fiscal years beginning on or after December 15, 2012.

> may be interpreted as consistent with a less thorough audit and/or auditors that lack skepticism and otherwise fail to challenge management.

V. Other Information ("OI")

It appears the PCAOB has determined that there is no meaningful support for auditor assurance on OI, including auditor assurance on MD&A. Therefore, the Proposal focuses on enhancing the auditor's responsibilities for and auditor reporting on OI. However, once again the threshold question comes to the fore as it seems that there is no meaningful demand to clarify or enhance the auditor's current responsibilities in regards to OI or to report thereon.

The Proposal includes new auditor responsibilities to read and evaluate OI for consistency of amounts with the financial statements; consistency of qualitative statements with the financial statements; comparability with relevant audit evidence obtained and conclusions reached; and mathematical accuracy. The Proposal also includes a new requirement for auditor reporting on OI. The Proposal would require that the auditor's report describe the auditor's responsibilities for other information and state whether the other information contains a material inconsistency, a material misstatement of fact, or both (based on the relevant audit evidence obtained and conclusions reached during the audit).

Unfortunately, the proposed reporting is likely to confuse rather than inform investors. First, the auditor is providing no assurance on OI. Yet the proposed auditor report implies there is some (new) level of service—called an "evaluation"—based on which the auditor is providing at least negative assurance with respect to OI. For example, illustrative language in the Proposal for the auditor's report includes: "Based on our evaluation, we have not identified a material inconsistency or a material misstatement of fact in the other information."[12] An oddity is that the Proposal would have auditors reporting on the results of what they do not do, as the OI is neither audited nor reviewed.

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[12] *See* paragraph 14(b) (page A2-7) of the Proposal.

Discussions at the PCAOB's November 2013 Standing Advisory Group ("SAG") meeting revealed very different views on what the auditor should reasonably know with regard to OI based on the relevant audit evidence obtained and conclusions reached during the audit. The Proposal does not sufficiently tie the auditor's responsibilities for OI to the financial statements. This will be a source of great confusion and may force auditors into the position of having to do additional work.

The Proposal also has auditors intruding into areas such as MD&A that are intended to be where management discusses the state of the business. In doing so, MD&A uses qualitative, non-financial, and forward looking information. Again, it makes no sense to require the auditor "to read and evaluate" these MD&A disclosures (or OI generally) not derived from the financial statements. Current PCAOB standards are appropriate in regards to the role and responsibilities for OI.

OI also includes proxy statements, which raises the practical question of how the auditor reports on information not yet issued (or necessarily fully available to the auditor) at the date of the auditor's report.

These points illustrate another of our concerns with the Proposal—namely that the PCAOB is potentially undermining the disclosure requirements of others, including the SEC.

In addition, the Proposal creates confusion as to the new performance standards. Discussions at the PCAOB's November 2013 SAG meeting suggested that the PCAOB intends to formalize current practice with respect to OI. Yet, there was a good deal of ambiguity and uncertainty expressed at the SAG meeting as to what it means to "read and evaluate" (proposed guidance) versus "read and consider" (current guidance). This confusion occurs notwithstanding the guidance in the Proposal in regards to "evaluate."

Discussions at the November 2013 SAG meeting also revealed differences of views on what constitutes a "material misstatement of fact" that falls within the intended purview of the Proposal and whether OI can involve immaterial information. All things considered, it appears that the Proposal significantly extends the auditor's responsibilities for OI and will have significant legal liability implications for auditors that need to be understood and addressed. As it stands, the Proposal will only create an expectations gap with respect to auditor responsibilities for OI.

VI. Auditor Tenure and Independence

The Proposal calls for several other changes in the auditor's report, including disclosing auditor tenure (that is the year the auditor began serving consecutively as the company's auditor), disclosing auditor independence (that is stating that the auditor is required to be independent in accordance with federal securities laws and applicable rules and regulations of the SEC and PCAOB), and including various statements regarding the auditor's responsibilities related to fraud and the notes to the financial statements.

First, is not obvious that more information in the auditor's report on either independence or auditor tenure is necessary. As to auditor independence, the auditor's report is typically headed "Report of the Independent Registered Public Accounting Firm." Furthermore, the audit committee reports in the company's annual proxy statement about its oversight and monitoring of auditor independence matters. So, on the one hand, the need for any additional information in regards to auditor independence is not obvious. And, on the other hand, if there is a need, it is better addressed by other regulators such as the SEC.

As to auditor tenure, it is not obvious how tenure connects to the nature of the auditor's work performed or the auditor's opinion and, therefore, why this information belongs in the auditor's report. As the audit committee has the responsibility to oversee and monitor the selection and retention of the audit firm, again the audit committee report in the annual proxy statement provides a more appropriate placement for such a disclosure. And, a number of audit committees already disclose this information in the proxy statement.

By including tenure information in the auditor's report, the Proposal implies some systematic connection between audit quality and tenure. However, as explained in the Proposal and emphasized by one Board member, the PCAOB "has not reached a conclusion regarding the relationship between audit quality and auditor tenure and the Board's inspection process has not been designed to determine a relationship between audit quality and auditor tenure." Thus, the PCAOB does not have "any data indicating that audit tenure has any correlation with audit quality." Yet, "the mere fact that the Board requires a disclosure about audit tenure, however, might suggest that the Board believes the information to be meaningful."[13] By that token, as an example, anecdotal musings, by the SEC, of ethical lapses by attorneys would not pass muster for regulatory action requiring disclosure of law firm tenure by companies.

Lastly, we would like to reiterate that the CCMC supports working to achieve one set of global high quality auditing standards through the convergence of PCAOB auditing standards with those of the AICPA's Auditing Standards Board ("ASB") and the IAASB. Particularly when it comes to auditor reporting, one global model for mandated auditor reporting seems not only desirable but essential. We encourage the PCAOB to work with the IAASB and ASB to develop an appropriate model.

VII. Cost Benefit Analysis

The Proposal recognizes that the 2012 Jumpstart Our Business Startups ("JOBS Act") now makes economic analysis a necessary pre-condition for applying new PCAOB auditing standards to an audit of any emerging growth company (EGC). Specifically, JOBS Section 103(a) (3) requires that rules adopted by the Board after the date of enactment of the JOBS Act (in April 2012) shall not apply to an audit of any EGC, unless the Commission determines that the application of such additional requirements is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation. Notwithstanding that JOBS Act exempted EGCs from any subsequent standard-setting on AD&A and, therefore, EGCs would likewise be exempted from CAMs, the need for subjecting this initiative to robust economic analysis remains.

The CCMC recognizes that the PCAOB is soliciting information on the estimated costs and burdens that will be placed upon businesses and auditors as a result of the Proposal, and to solicit other information on how the Proposal would contribute to investor protection and promote efficiency, competition, and capital

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[13] *See Statement on Proposed Auditing Standards Regarding the Auditor's Report and the Auditor's Responsibilities Regarding Other Information"* by Jay D. Hanson, Board Member, PCAOB Open Board meeting on August 13, 2013.

formation. Further, the CCMC recognizes that the Proposal does not represent a final standard. Thus, additional evidence and analysis will occur and be reflected in any ensuing standard adopted by the Board and submitted for approval by the SEC.

Nonetheless, the CCMC suggests that the PCAOB needs an appropriate and transparent framework for economic analysis—one that will serve as a template for such analysis across all PCAOB rulemaking initiatives. One example of such a framework is the SEC staff memorandum, "Current Guidance on Economic Analysis in SEC Rulemakings" dated March 16, 2012.

Thus, the CCMC recommends that the PCAOB develop guidance on economic analysis for PCAOB rulemaking. Once developed, the PCAOB should expose the framework for public comment and the finalized framework should be publicly disclosed. As a starting point, the PCAOB could consider adapting the framework in the SEC staff memorandum to an audit context.

In addition, the framework should preclude reliance on generic economic arguments that could apply to almost any proposed auditing standard regardless of topic or substance. The framework should likewise discourage conjectures or speculative type arguments, including those related to reducing information asymmetries and cost of capital that are not grounded in credible evidence related to the specifics of the initiative at hand. The framework should also articulate an appropriate economic baseline against which to measure the proposed requirements likely economic impact.

Finally, in regards to this Proposal, if the PCAOB decides to proceed with this initiative in spite of all the concerns expressed about it, the PCAOB should recognized that auditor reporting of CAMs, in particular, is a giant experiment. As such, the CCMC recommends that any standard-setting that results from this initiative should include a sunset provision (of within three to five years of its effective date). Only after a robust post-implementation review of the costs and the benefits and a determination that the benefits exceed the costs should a similar or revised auditor reporting standard be allowed to be re-implemented.

Conclusion

Once again, the CCMC appreciates the opportunity to comment on the Proposal.

The CCMC continues to have serious concerns regarding the Proposal – namely, that the Proposal blurs lines of corporate governance, may create duplicative disclosures and may raise liability for auditors and businesses which ultimately harms investors. We believe that these issues should be addressed before the Proposal moves forward.

In the alternative, the CCMC believes that the PCAOB should work with the SEC and FASB to move forward on a broad agenda of financial reporting modernization as outlined in the CCMC's letter October 9, 2013 to SEC Chair Mary Jo White.

Thank you for your consideration and the CCMC stands ready to assist in these efforts.

Sincerely,

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CENTER FOR CAPITAL MARKETS COMPETITIVENESS

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September 14, 2011

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Re: Request for Public Comment *on Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements and Related Amendments to PCAOB Standards and Notice of Roundtable (PCAOB Release No. 2011-003, June 21, 2011, Rulemaking Docket Matter No. 34)*

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

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 recognizes the vital role external audits play in capital formation and supports efforts to improve audit effectiveness. We appreciate the opportunity to comment on the Public Company Accounting Oversight Board's ("PCAOB") *Concept Release on Possible*

Revisions to PCAOB Standards Related to Reports on Audited Financial Statements ("Concept Release").

The CCMC has a number of concerns regarding the issues and concepts outlined in the Concept Release including those related to:

- The potential increase in financial reporting complexity;
- The apparent overturning of fundamental precepts of financial reporting;
- The conflict with other forms of mandated corporate disclosure;
- The fundamental shift in the role of the auditor and communications;
- The potential activities that may fall outside of the legal mandates of the PCAOB's powers and encroachment upon mandated powers of other regulators and standard setters;
- The potential increase in litigation harmful to investors and the capital markets; and
- The failure to weigh recommendations made by other entities to reduce financial reporting complexity.

In reviewing the intent and purpose behind the Concept Release, the CCMC believes that the PCAOB should work with the Securities and

Exchange Commission ("SEC") and Financial Accounting Standards Board ("FASB") to:

- Take a coordinated holistic approach to reducing financial reporting complexity;

- Create a Financial Reporting Forum allowing all stakeholders to work together to identify long-term financial reporting issues and solutions; and

- Follow transparency and disclosure standards, used by regulators, in the development of standards and concept releases.

Discussion

The stated objective of the Concept Release is to seek public comment on auditor reporting alternatives that could provide investors with more insight into the company's financial statements, or possibly other information outside the financial statements, and more transparency into the audit process.

The Concept Release presents four alternatives (auditor's discussion and analysis ("AD&A"), required and expanded use of emphasis paragraphs, auditor assurance on other information outside the financial statements, and clarification of the standard auditor's report). Nonetheless, the Concept Release makes clear that the PCAOB intends to retain the current ("pass/fail") approach of the standard auditor's report. Indeed, as recognized in the Concept Release, the PCAOB has heard overwhelming support from all stakeholder groups for retaining this long-standing approach to auditor reporting. Thus, the alternatives presented in the Concept Release would be additive to the current approach.

Before addressing any specifics in regards to the Concept Release, it is important to consider the threshold question of whether the PCAOB should undertake a standard-setting initiative. CCMC notes that standards related to auditor reporting are long-standing and have served the test of time. While this does not mean that improvements should not be considered by the PCAOB, it does suggest the need to exercise caution in doing so.

The CCMC has a number of concerns about the PCAOB's approach to this reporting project and the alternatives discussed in the Concept Release. These concerns are outlined in the remainder of this letter.

I. Approach to Developing the Concept Release

An overarching concern is that, in developing the Concept Release, the PCAOB has not taken a comprehensive and holistic approach to considering the role of *both* auditors and audit regulators in achieving an optimal level of quality and clarity in public company financial reporting. The PCAOB has not clearly articulated the current structural audit weaknesses in public company financial reporting, which is a necessary predicate to address the threshold question of whether the PCAOB should undertake a standard-setting initiative on auditor reporting. In addition, the Concept Release does not appreciate that the PCAOB as the regulator of public company audits actually shares responsibility with auditors for audit quality. Instead, the Concept Release appears intent on transferring responsibilities to auditors when it comes to auditor reporting.

A more holistic approach to considering the interplay of audit and financial reporting regulation could likely have informed this PCAOB auditor reporting project in other ways, including by raising questions about some of the essential premises that underlie it. For example, in response to the 2008 economic crisis, FASB has promulgated new standards and the SEC has enacted new regulations. There is no indication that the PCAOB considered these FASB and SEC activities in developing the alternatives discussed in the Concept Release.

Furthermore, the project does not appear to have taken into account the insights and recommendations from prior blue-ribbon advisory committees, such as the SEC Advisory Committee on Improvements to Financial Reporting ("CIFiR"), the U.S. Department of the Treasury Advisory Committee on the Auditing Profession ("ACAP"), and the Panel on Audit Effectiveness.[1] For example, ACAP recommended that the PCAOB narrow the expectation gap and provided useful guidance to the PCAOB for exercising its responsibility to do so; whereas, the Concept Release seems intent on delegating this regulator responsibility to auditors, including through the assignment of new responsibilities.

Moreover, the reports and recommendations of previous advisory committees should have provided perspective on the feedback that the PCAOB received during its outreach activities. For example, it is financial reporting complexity, including disclosure overload, which is at the heart of some of what the PCAOB heard from its outreach activities. Calls by investors for "tell us what matters" and "give us a roadmap" should be less about asking auditors to weigh-in with their views (as the Concept Release suggests with alternatives such as AD&A and expanded and required use of emphasis of matter paragraphs), and more about the PCAOB working

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[1] Recommendations of the Panel on Audit Effectiveness are discussed in a subsequent section of this letter on going concern reporting and disclosures.

with other regulators, including the SEC and FASB, to help fix the essential problem.

Disclosures for public companies and their investors are a triad that involves the SEC, FASB, and the PCAOB. It is imperative that this triad work in harmony to provide a rational coordinated system of disclosure for all public company stakeholders. A failure to do so will create competing disclosures and confusion, sowing uncertainty and doubt in the capital markets for investors and companies alike. The CCMC once again reiterates its call for a Financial Reporting Forum that will provide for coordination as well as the identification and resolution of problems that may drive complexity and obfuscation.[2]

Importantly, complexity challenges a premise for this project that expanded auditor reporting in advance of the 2008 economic crisis might have been helpful in assessing the quality of the financial statement and provided early warning signals regarding potential issues.

In its August 2008 Final Report, CIFiR recognized that over time "financial reporting has become a burdensome compliance exercise with decreasing relevance to investors" (p. 18). CIFiR identified financial reporting complexity as the key factor driving the disconnect between current financial reporting and the information necessary to make sound investment decisions. Thus, CIFiR made a number of recommendations to the SEC, FASB, and PCAOB to improve the usefulness and reduce the complexity in financial reporting. While some progress has been made, many of CIFiR's recommendations have yet to be taken up by the appropriate bodies – in particular the PCAOB.

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[2] See CCMC testimony provided to the U.S. Senate Subcommittee on Securities, Insurance and Investment's April 6, 2011 hearing: *The role of the accounting and auditing profession in preventing another financial crisis.*

One example of a CIFiR recommendation not yet addressed by the PCAOB relates to judgment. Whereas discussions in the Concept Release indicate that some participants in the PCAOB's outreach activities expect a single "right answer," CIFiR appreciated the role of judgment and understood that there is not necessarily one right answer in accounting and auditing matters. In turn, CIFiR recommended that the PCAOB develop and articulate guidance related to how the PCAOB, including in its inspections and enforcement divisions, would evaluate the reasonableness of judgments made based on PCAOB auditing standards. CIFiR also recommended that the PCAOB's statement of policy should acknowledge that the PCAOB would look to the SEC to the extent that the PCAOB would be evaluating the appropriateness of accounting judgments as part of an auditor's compliance with PCAOB auditing standards.[3]

To summarize, CIFiR understood the need to take a comprehensive and holistic approach to overcoming the problem of financial reporting complexity. The CCMC recommends that the PCAOB adopt such an approach and redirect its efforts and resources from initiatives that will only exacerbate the disclosure overload problem. All financial reporting stakeholders would be better served if the PCAOB worked with other regulators and standard-setters, such as the SEC and FASB, to implement the CIFiR recommendations; to help update and improve existing disclosure requirements and eliminate redundant and unnecessary disclosures; to facilitate the ability of management (rather than lawyers) to drive discussions in MD&A, including those around critical accounting estimates; and to help address issues around the auditability of GAAP.

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[3] CIFiR recommended that the SEC issue a statement of policy articulating how it evaluates the reasonableness of accounting judgments and include factors that it considers when making this evaluation. CIFiR then went on to suggest some components of an accounting policy statement related to the choice and application of accounting principles, as well as estimates and evidence related to the application of accounting principles. CIFiR's suggested components are consistent with advice on the SEC's website for consultations on accounting matters with the Office of the Chief Accountant and the Division of Corporation Finance. However, CIFiR made no such suggestions in regards to an audit judgment framework.

The CCMC also recommends that the PCAOB work with others such as the SEC and FASB to better understand the responsibilities of users when it comes to financial reporting. The Concept Release seems not to appreciate that users are heterogeneous and, therefore, their information needs vary. General purpose financial reporting, as represented by GAAP financial statements, is designed to meet the needs of the broad set of all users and not the demands of any particular special interest group.

II. Overturning a Fundamental Premise of Financial Reporting

Another major CCMC concern is that the Concept Release overturns a fundamental premise of financial reporting—namely that the financial statements and disclosures are the responsibility of management. This premise likewise extends to other information that accompanies the financial statements, such as Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A"), which management prepares in accordance with SEC requirements, as well as other information outside the financial statements.

Management's financial reporting responsibility includes the selection and application of Generally Accepted Accounting Principles ("GAAP") and the determination of the many estimates and judgments required by GAAP and SEC financial reporting requirements, including MD&A disclosures. Management's responsibility for financial reporting extends beyond compliance with GAAP to determining the "quality" of the company's financial reporting within GAAP. In turn, the board of directors, largely through the audit committee, exercises oversight of management's financial reporting, including the company's annual (Form 10-K) and quarterly (Form 10-Q) filings with the SEC.

The independent audit firm's responsibility is to express an opinion as to whether the company's annual financial statements, including notes thereto, are presented fairly, in all material respects, in conformity with GAAP.[4] The auditor's report is the mechanism by which the audit firm communicates this opinion. The SEC does not accept filings that contain audited financial statements with qualified or adverse audit opinions.[5] Thus, for public companies, the auditor's unqualified audit opinion indicates that all material matters have been resolved.[6]

An essential element of the fundamental premise of financial reporting is that the auditor is not an original source of information about the company. Auditors' legal and ethical obligations recognize and reinforce this point by requiring that auditors treat all company-specific information as confidential.[7] Except in rare circumstances where management and the board of directors have failed to disclose certain information, as provided for under PCAOB auditing standards and SEC regulations,[8] auditors are *precluded* from disclosing any company-specific

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[4] Quarterly financials included in Form 10-Q filings with the SEC are reviewed by the auditor, rather than audited.

[5] The Concept Release does not explore the implications of this prohibition or suggest altering it.

[6] However, auditing standards provide that audit reports with unqualified opinions can contain additional explanatory or emphasis of matter language, including when there is substantial doubt about the entity's ability to continue as a going concern, there has been a material change between periods in accounting principles or their method of application, there are significant transactions with related parties, or unusually important subsequent events have occurred.

[7] Rule 301 of the American Institute of Certified Public Accountants ("AICPA") Code of Professional Conduct states that "a member in public practice shall not disclose any confidential client information without the specific consent of the client." The PCAOB did not adopt Rule 301 as part of its interim standards. Apparently the PCAOB's decision was based on a determination that incorporation of Rule 301 was not necessary to fulfill the Board's mandate under Section 103(a)(1) and (3) of The Sarbanes-Oxley Act of 2002 ("SOX"). The PCAOB has assured that this determination did not reflect a decision that auditor confidentiality requirements imposed by other authorities were inappropriate. In adopting conforming amendments in conjunction with Auditing Standard No. 6 ("AS No. 6"), *Evaluating Consistency of Financial Statements*, the PCAOB reaffirmed that it sought neither to modify nor detract from existing confidentiality requirements. Nonetheless, in approving AS No. 6 in September 2008, the SEC encouraged the PCAOB to develop and adopt a rule addressing the auditor's responsibility with respect to maintaining the confidentiality of client information. The PCAOB has yet to do so.

[8] Examples include information under certain circumstances in reports in connection with the termination of the audit engagement and reports that may be required pursuant to Section 10A(b)1 of the Securities Exchange Act of 1934 relating to an illegal act that has a material effect on the financial statements.

information to outside parties. Nonetheless, the Concept Release includes alternatives, in particular an AD&A, that represent a radical departure from the bedrock premise of financial reporting.

Further, at first blush it would appear that the proposed AD&A would be in direct conflict with the MD&A required by the SEC. Accordingly it would seem that such a system would provide competing disclosures that will increase complexity and create confusion for investors. Seemingly, that would appear to be a situation that the SEC could not allow to develop.

As described in the Concept Release, an AD&A would provide financial statement users with a view of the audit and financial statements "through the auditor's eyes" (p. 13). Importantly, the Concept Release recognizes that the auditor's perspectives about the company's financial statements could differ from those of management.

According to the Concept Release, AD&A would give the auditor the ability to discuss significant matters, which could include such things as the auditor's views regarding management's judgments and estimates, accounting policies and practices, and difficult or contentious issues, including "close calls." The Concept Release goes on to explain that:

> *Additionally, an AD&A could provide the auditor with discretion to comment on those material matters that might be in technical compliance with the applicable financial reporting framework, but in the auditor's view, the disclosure of such matters could be enhanced to provide the investor with an improved understanding of the matters and their impact on the financial statements. And, AD&A could also highlight those areas where the auditor believes management, in its preparation and presentation of the financial statements, could have applied different accounting or disclosures* (p. 13).

Needless to say, providing auditor views and perspectives would represent a profound shift in the role and responsibilities of the independent auditor vis-à-vis management and the board of directors/audit committee. AD&A would necessitate the auditor becoming an original and competing source of company-specific information.[9] While it is not clear that the PCAOB would have the authority to enact this sea change, on principle, the CCMC strongly disagrees with any move by the PCAOB in this direction.

Investors need factual information to make decisions with their goal being a return on investment. Those decisions are premised on the health, direction and management of a company. An auditor's opinion in AD&A may be considered Monday morning quarterbacking that may not even be welcomed by investors generally. For that matter why not create a disclosure on the opinions of top financial reporter's opinions on management decisions. While everyone may have an opinion, it may not provide relevant facts or substance for investment decisions.

Moreover, any such change in the fundamental premise of financial reporting would likewise have significant implications for auditors from the standpoint of legal liability. AD&A may even create new avenues for legal actions against auditors. For example, the U.S. Supreme Court recently reaffirmed its decision in Central Bank[10] that precludes private securities fraud actions against secondary actors such as auditors. As described in the Concept Release, it appears that an AD&A would move the auditor into the position of being an original maker of statements. The auditor would have ultimate authority and control over AD&A, including its content and

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[9] As subsequently discussed, a similar argument can be made for required and expanded use of emphasis of matter paragraphs in all audit reports as this alternative would necessitate that the *auditor* determine significant matters to highlight and reference where those matters are further disclosed by management in the financial statements.

[10] *Central Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164 (1994).

whether and how to communicate it. As a consequence, Rule 10b-5 could then apply to auditors, as plaintiffs in private actions could allege the auditor directly or indirectly made an untrue statement of a material fact in connection with the purchase or sale of securities.

III. Additional Practical Considerations

Setting aside disagreement on fundamentals, the Concept Release also does not appreciate the full range of practical implications from adding an AD&A requirement that go well beyond effects on the timing of the delivery of audit reports. For example, it seems unlikely that expressing auditor views on financial statement matters in an AD&A-type report could be the end of it. Investors and other third-parties would likely call for clarification, additional insights, and further explanations from auditors in order to understand the auditor's views and to help reconcile, as necessary, such views with those of management. Would auditors then need to issue press releases and hold conference calls to meet these demands for further information? Would SEC reviews by the Division of Corporation Finance come to involve reviewer comments addressed to auditors? Likewise, in putting the auditor in the position of being an original and competing source for financial information about the company, one can easily envision that an AD&A-type responsibility could create a material adverse interest with management and, therefore, raise questions about auditor independence under extant requirements.[11] And the list of problematic consequences goes on.

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[11] The Concept Release describes one rationale for an AD&A as being to "give the auditor greater leverage to effect change and enhance management disclosure in the financial statements, thus increasing transparency to investors" (p. 13). However, as previously discussed, this rationale involves transforming the role of the auditor vis-à-vis that of management and the board/audit committee. Additionally, the Concept Release fails to appreciate that under extant arrangements, the need for the financial statements to comply with GAAP to obtain an unqualified audit opinion provides auditors with powerful "leverage." Otherwise, extant auditing standards support the auditor's role in facilitating the operation of corporate governance mechanisms related to the quality of financial reporting, via requirements such as the one on auditor communications with audit committees about the "quality" of the company's accounting principles (within GAAP), in addition to their compliance with GAAP.

Other aspects of the AD&A alternative involve suggestions for an auditor narrative with information about the audit, including audit risks identified in the audit, audit procedures and results, and auditor independence. Regarding the latter, there is no indication in the Concept Release why current disclosures on auditor independence are inadequate, including proxy statement disclosures by audit committees. Indeed, it raises the question of whether investors participating in the PCAOB's outreach activities are even reading the information now available to them.

As to more information about the audit,[12] it is a difficult to envision how the auditor could condense all the work done on each engagement related to audit risks identified, audit procedures performed, and results obtained into a few sentences or even paragraphs. It is also a challenge to understand how any such condensation would be meaningful. PCAOB auditing standards, which are publicly available, provide the basis for performing audits. PCAOB inspections review the application of and adherence to such standards on individual engagements. The Concept Release does not make the case for why or how adding a reporting requirement for auditors to provide more details about their performance on each individual engagement would provide useful information to investors and other users.

Relatedly, the Concept Release is wanting when it comes to illustrating the alternatives. Illustrative examples that only contain placeholders for substantive information are unhelpful. The PCAOB should have developed substantive illustrations or even used field testing to assist in evaluating the usefulness and limitations of the various suggestions that emerged from their outreach activities *before* issuing a Concept Release.

[12] More information about the audit is also suggested under the alternative for required and expanded use of emphasis of matter paragraphs. For example, the Concept Release states that "under this alternative, the auditor also could be required to comment on key audit procedures performed pertaining the identified matters" (p. 20).

Otherwise, legal considerations and the need for audit firms to maintain consistency across engagements and over time preclude alternatives involving auditor narratives from being "free-writing" exercises. Before mandating AD&A or the expanded use of emphasis of matter paragraphs on all audits, criteria would need to be developed by the PCAOB (and audit firms would likely need to further refine such criteria). Even information currently part of internal communications among auditors, management, and boards/audit committees cannot be moved to the public arena without such criteria. For example, PCAOB auditing standards related to auditor communications with audit committees recognize that "objective criteria have not been developed to aid in the consistent evaluation of the quality of an entity's accounting principles as applied in its financial statements" (AU 380.11).[13]

All things considered, rather than meaningful information, requirements for AD&A and the expanded use of emphasis of matter paragraphs on all audits appear more likely to add boilerplate to that already cluttering SEC filings. Boilerplate is the tip of the financial reporting complexity iceberg.

As we previously discussed, because of overly complex and detailed periodic reporting, CIFiR likewise heard that investors want to be told "what matters." However, after extensive deliberations, CIFiR did *not* recommend that auditors step-in to fill the breach; it did not recommend such things as an AD&A or required and expanded use of emphasis of matter paragraphs on all audits.[14] Rather, CIFiR recognized the importance

[13] Moreover, altering the auditor's responsibilities to involve external disclosure of AD&A-type information would likely transform current relationships and interactions among auditors, management, and boards/audit committees to the detriment of audit quality.

[14] Members of CIFiR included investors and representatives of other financial statement users along with financial executives and board members, auditors, and securities lawyers. In addition, the chairman of the PCAOB was an official observer on CIFiR.

of the fundamental premise of financial reporting, as previously discussed. Thus, CIFiR recommended that *management* provide a short executive summary at the beginning of a company's annual report on Form 10-K (with material updates in quarterly reports on Form 10-Q). CIFiR suggested the summary describe concisely the most important themes or other significant matters with which management is primarily concerned, along with a page index showing where investors could find more detailed information on particular subjects (p. 3).

IV. Additional Assurance Services

The Concept Release presents another alternative that would *require* auditors to provide assurance on information outside the financial statements such as MD&A (or portions thereof, such as critical accounting estimates), non-GAAP information, and/or earnings releases. Current PCAOB auditing standards describe the auditor's responsibilities regarding other information outside the financial statements in documents containing audited financial statements. These responsibilities include reading and considering whether such information or the manner of its presentation is materially inconsistent with the financial statements or represents a material misstatement of fact. The Concept Release fails to make the case for why this current arrangement is inadequate. Likewise, the Concept Release fails to identify the flaws in earnings releases that would be fixed with auditor assurances or how such assurances would otherwise be value-added in this context.

Moreover, extant PCAOB attest standards allow the auditor to be engaged to attest on MD&A and the standards provide requirements for such engagements. Yet, few if any public companies engage their auditors for this additional assurance service on MD&A. Further, CCMC is not aware of any instances where shareholders have requested a company to do so. The lack of any voluntary demand for additional assurance services is revealing and provides a basis for concluding that proposals to *mandate* such services fail cost/benefit considerations.

V. Adding Clarifying Language to the Auditor's Report

The fourth alternative presented in the Concept Release would provide for adding clarifying language in the existing standard auditor's report. The Concept Release suggests that language around reasonable assurance, the auditor's responsibility for fraud, the auditor's responsibility for financial statement disclosures, management's responsibility for the preparation of the financial statements, the auditor's responsibility for information outside the financial statements, and auditor independence would be potential areas for clarification. These suggestions represent refinements to the current auditor's report and, overall, are not objectionable in concept, although it is hard to argue the need for all of them individually. For example, in regards to independence, currently the audit report is labeled as the "report of the independent registered public accounting firm" and, as previously noted, proxy statements provide disclosures on auditor independence. So, it is not clear why any further disclosures contemplated by the Concept Release would be useful information rather than added boilerplate.

VI. Going Concern Reporting and Disclosures

At the PCAOB's open board meeting on June 21, 2011 to approve the Concept Release, one board member focused on going concern reporting by auditors. For example, the statement of Mr. Harris has an entire section on "Going Concern Opinions: A Rarely Used Tool." This is curious because the Concept Release is *silent* on this topic; and, it creates some confusion about the direction of this auditor reporting initiative.

Going concern is long recognized as an area in need of FASB attention. Although the financial statements are prepared on the assumption that the entity will continue as a going concern, auditing standards contain the only real guidance on going concern. More than a decade ago, the Final Report (August 31, 2000), of the Panel on Audit Effectiveness recommended that the FASB (1) define the going concern concept and clarify that management, not the auditor, has the primary responsibility to assess whether the entity has the ability to remain a going concern, (2) consider the appropriateness of the one-year time horizon in SAS No. 59 (i.e., the FASB should evaluate this time horizon and recognize its importance to auditors in framing their audit reports), and (3) promulgate explicit going concern disclosure requirements to fit various circumstances (pp. 61-62).

The FASB has had a going concern project on its agenda for a number of years now, but the FASB has yet to finalize any guidance in this area. If the PCAOB heard from its outreach activities in response to the 2008 economic crisis that this is an area of concern for investors, it would seem that this project should have provided a golden opportunity for the PCAOB board itself to become engaged in working with the FASB and SEC to overcome this perceived deficiency in GAAP and address other issues related to the auditability of GAAP.

VII. Outreach, Transparency, and Cost/Benefit Considerations

Chairman Doty's statement at the PCAOB's open board meeting notes the "fluid" nature of feedback from the PCAOB's outreach activities on this project. However, this raises issues about the transparency of the PCAOB's outreach activities.

On one hand, the CCMC appreciates the extensive discussion of the feedback received by the PCAOB's staff from its outreach activities contained in the Concept Release, including Appendix C. On the other hand, the discussion is mostly confined to the alternatives pursued in the Concept Release rather than those considered but dropped along the way (e.g., going concern reporting).

In addition, it is difficult to interpret the information in the Concept Release because discussions with participants were private (no transcript is publicly available of the outreach discussions) and apparently informal (the PCAOB has provided no sample questionnaire or interview script).[15] Further, the Concept Release does not identify the number of participants in the PCAOB's outreach activities or list their names and organizations. And, while overall categories of participants are given, discussions of the various views, in particular those in Appendix C, mostly just combine all categories into "outreach participants," with only qualitative information on the degree of commonality in views noted by using terms such as "some" or "many" outreach participants.

The CCMC strongly agrees that the PCAOB should consult with and have access to a full range of perspectives among all users of financial statements. However, these activities need to have transparency. The CCMC appreciates that the PCAOB has included auditor reporting issues on the agendas at various public meetings of its advisory groups, including its Standing Advisory Group ("SAG") and IAG. Public roundtables are another mechanism for conducting public outreach with transparency and the PCAOB has announced plans to hold one or more roundtables in conjunction with this project. Nonetheless, as noted, the CCMC has

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[15] CCMC understands that the PCAOB includes the March 2011 Investor Advisory Group ("IAG") survey as part of its outreach activities and some details of participants in that survey are publicly available, including that IAG members themselves were among the survey participants.

concerns about the lack of transparency around many of the PCAOB's outreach activities that produced this Concept Release, which are consistent with concerns the CCMC has previously expressed about the transparency of the PCAOB's activities and due process generally.[16]

Finally, most of the reporting alternatives presented in the Concept Release would involve additional costs. Feedback from the PCAOB's investor outreach that informed the alternatives presented in the Concept Release appears to underplay the existence and significance of any additional costs. Indeed, in the main, it does not appear that cost/benefit considerations played a major role in the discussions with outreach participants.[17]

Conclusion

In conclusion, the CCMC appreciates the opportunity to comment on the Concept Release. In closing, we would like to reiterate that the CCMC supports working to achieve one set of global high quality auditing standards through the convergence of PCAOB auditing standards with those of the AICPA's Auditing Standards Board ("ASB") and the International Auditing and Assurance Standards Board ("IAASB"). In this regard, CCMC notes that the Concept Release gives short shrift to activities by other audit standard-setters related to auditor reporting and fails to provide any comparison of relevant portions of PCAOB auditor reporting standards with those of the ASB and IAASB as part of considering improvements to PCAOB auditing standards. The CCMC

[16] For example, see the October 7, 2009 letter from the U.S. Chamber of Commerce CCMC to the Honorable Daniel L. Goelzer, Acting Chairman of the PCAOB.

[17] For example, during discussions at the March 2011 IAG meeting, some IAG members dismissed cost concerns for AD&A with assertions that no additional audit work would be required as auditors would just be disclosing to investors information currently communicated with audit committees.

encourages the PCAOB to reconsider its "go it alone" approach to audit standard-setting.

Thank you for your consideration and the CCMC stands ready to assist in these efforts.

Sincerely,

CENTER FOR CAPITAL MARKETS
COMPETITIVENESS

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October 20, 2011

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

Re: Request for Public Comment *on Concept Release on Auditor Independence and Audit Firm Rotation and Notice of Roundtable (PCAOB Release No. 2011-006, August 16, 2011, PCAOB Rulemaking Docket Matter No. 37)*

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, recognizes the vital role external audits play in capital formation, and appreciates the opportunity to comment on the Public Company Accounting Oversight Board's ("PCAOB") *Concept Release on Auditor Independence and Audit Firm Rotation* ("Concept Release").

The CCMC has serious concerns about the Concept Release particularly the consideration of mandatory audit firm rotation. The premise for the Concept Release is not grounded in facts and therefore ill-conceived. Movement towards mandatory audit firm rotation will harm investors, endanger the competitive position of American public companies, degrade audit quality, and take a path that has, in the past, been explicitly rejected by Congress and the Securities and Exchange Commission ("SEC").

Additionally, the Concept Release is at odds with initiatives to reduce unnecessary and burdensome regulation as the economy struggles to recover from the recent recession and avoid another one.

Accordingly, the CCMC believes that the PCAOB should withdraw the Concept Release. The CCMC's concerns are outlined in more detail in the remainder of this letter.

I. Discussion

The current form of audit practice and engagement is rooted in laws and regulations dating back to the passage of the Securities Act of 1933 and the Securities Exchange Act of 1934 ("the 1933 and 1934 Securities Acts"). This structure has depended upon a private firm engagement with a public company to produce audited financial reports, under SEC supervision, to provide investors with decision useful information. An important feature of this structure has been the independence of auditors.

Since the passage of the 1933 and 1934 Securities Acts and the designation of the SEC as the arbiter of financial reporting in the United States, there have been periodic reviews of financial reporting structures with the implementation of reforms when needed.

In that context, mandatory audit firm rotation is in fact an old idea. More than three decades ago, mandatory rotation was considered and rejected by the Commission on Auditors' Responsibilities (the "Cohen Commission") as costly and with no net benefit to investors. The Cohen Commission stated that the lack of auditor familiarity with a client in the early years of engagement would cause more harm than benefit for investors.[1] The Cohen Commission concluded that the audit

[1] See *The Commission on Auditors' Responsibilities: Report, Conclusions, and Recommendations* (1978), pp. 108-109. Curiously, in the end, the Concept Release acknowledges that mandatory audit firm rotation will end up lowing audit quality and then asks how to mitigate this effect (pp. 23-24).

committee is in the best position to evaluate audit effectiveness and decide if appropriate, to rotate audit firms. We believe that this conclusion remains true today.

In 1994, the SEC rejected the notion of mandatory firm rotation and stated that there was not a need for rules changes or legislation to further that goal.[2] Following significant financial reporting failures in the Enron and WorldCom incidents, Congress explicitly rejected mandated audit firm rotation instead choosing to mandate audit partner rotation and strengthening the role of audit committees in the debate and passage of the Sarbanes-Oxley Act of 2002 ("SOX").

So while Congress and the SEC have explicitly rejected audit firm rotation, in favor of other reforms, the threshold questions for the consideration of mandatory audit firm rotation are:

- What has changed to raise the issue again?
- What evidence exists to consider mandatory firm rotation?

The CCMC believes that the PCAOB has failed to provide answers to these questions and therefore also believes that the concept release should be withdrawn.

a. Has Audit Regulation Failed?

This is in fact the fundamental question that must be answered. To drastically change a structure that has been in place for 78 years would seemingly require pervasive financial reporting failures. Pervasive failures of this sort would require a close examination of the PCAOB's almost 10 year stewardship of audit regulation.

The Concept Release does not present any evidence of pervasive failures, and as will be discussed later, the failure to provide factual evidence is a fatal flaw in the consideration of the Concept Release.

[2] SEC Office of the Chief Accountant, Staff Report on Auditor Independence (1994).

With this Concept Release, the PCAOB is advancing the proposition that the level of audit quality for public companies is somehow inadequate.[3] If the system is inadequate, the PCAOB must explain how the regulatory system failed. This alleged inadequacy is in spite of all the regulatory activities of the PCAOB and others, such as the SEC (including SEC rules on auditor independence), and the efforts of audit committees. Indeed facts are not presented to support the premise that the existing regulatory and governance structures fall short of the mark.

In establishing the PCAOB as regulator for audits of public companies, with oversight by the SEC, SOX gave the PCAOB multiple powers to maintain and improve audit quality through registration, inspection, standard-setting, and enforcement. An alleged inadequacy of audit systems, by inference, means that these powers have either not been used well or not used at all. Similarly, abdicating these powers in favor of the extreme move of mandating audit firm rotation is tantamount to the PCAOB throwing up its hands and stating that audit regulation cannot work.

This implication, embedded in the Concept Release, also extends to SOX mandated corporate governance structures. SOX gives audit committees the responsibility for the appointment, compensation, and oversight of the independent audit firm, along with responsibility for resolving any disagreements between management and the auditor regarding financial reporting.[4] While SOX gives the PCAOB jurisdiction over audit firms, it does not give the PCAOB authority over audit committees; instead, that responsibility rests with the SEC.

A reading of SOX demonstrates that a fundamental reordering of the audit committee responsibilities and actions would have to emanate from the SEC and not the PCAOB. Mandating a set period for changing audit firms— which would preclude both longer and shorter periods (at least without regulatory consent of some form)— deprives audit committees of discretion and judgment, contravenes SOX and

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[3] Advancing this proposition is curious considering that the Concept Release states that, based on its experience conducting inspections, the Board believes public company audit quality has improved post-SOX under the PCAOB (pp. 15).

[4] In addition, many public companies now require shareholder voting to ratify the retention of the audit firm recommended by the audit committee.

audit committee responsibilities for audit firm selection, and otherwise constrains and unduly complicates the work of audit committees.

It appears, therefore, that the PCAOB has failed to provide a case for moving forward and may have overstepped its authority in emasculating SOX governance mandates.

If the PCAOB is concerned about improving the level of audit quality, it would be better served to present evidence as to the nature of the problem and focus its efforts on improving its standard-setting and inspection activities in response to any such problem. For example, the CCMC notes that the PCAOB auditing and quality control standards have not been substantially changed from those applicable on public company audits pre-SOX. Concept Releases, such as this one, distract stakeholders and divert the PCAOB board and staffs focus from these other standard-setting activities that may benefit investors and the marketplace.

b. Evidence Lacking to Support Mandatory Rotation

The PCAOB has failed to provide evidence to issue this Concept Release or move forward with a roundtable. The PCAOB does not provide any evidence from its own activities, including from its inspection process, that audit firm tenure is an issue. Indeed, the PCAOB admits that it has no evidence from its inspection process that audit firm tenure has any systematic relationship with inspection deficiencies. To overcome this fatal flaw, the PCAOB attempts to equate Part I inspection deficiencies to audit failures, although the Concept Release acknowledges that the use of the term "audit failure" describes a situation of not obtaining (or not documenting the evidence to support) the reasonable assurance that a financial statement is free of material misstatement. It does not mean that a financial statement is in fact materially misstated.[5]

So an "audit failure" as used in the concept release is actually not a failure per se regarding the accuracy of financial reports, but rather the identification of what the PCAOB determines to be a deficiency in the process of an audit, which itself may

[5] Concept Release (pp. 5)

involve a difference of professional views as to what constitutes appropriate evidence to support reasonable assurance.

To overcome this Catch 22, the Concept Release argues that mandatory audit firm rotation will promote auditor objectivity and professional skepticism. The Concept Release only offers anecdotal evidence from PCAOB inspections that auditor skepticism is a problem. However, it is unclear that the anecdotes provided in the Concept Release even involve a lack of skepticism. It is also unclear that mandatory audit firm rotation would provide a solution to any such "skepticism problems."[6] Indeed, the PCAOB admits that the Concept Release is not based on any "root cause" analysis of its inspection findings. In fact the PCAOB readily admits that it needs to deepen its understanding of the "root causes".[7] Thus, the PCAOB offers no persuasive evidence, from its own activities, linking auditor tenure with a lack of professional skepticism that, in turn, would be mitigated by mandatory audit firm rotation.

The Concept Release is also flawed in failing to fully appreciate the nature of professional skepticism. Skepticism involves both a mindset and a critical evaluation of audit evidence with two critical components –objectivity and expertise. Distinguishing between these two components of skepticism is essential. The Concept Release admits that the instances offered from inspections as indicative of a lack of skepticism could, instead, involve issues related to technical competence or experience (i.e., expertise not objectivity). But, the Concept Release then fails to appreciate that expertise (not objectivity) as the essential issue in fact undermines any arguments presented for mandatory audit firm rotation. Mandatory audit firm rotation is widely recognized as creating expertise concerns, especially in the earlier years of auditor tenure. Thus, mandatory audit firm rotation would have the effect of exacerbating (not mitigating) the "skepticism problems" used by the PCAOB to motivate the Concept Release.

Additionally, the Concept Release posits that mandatory audit firm rotation would improve auditor skepticism because "an auditor that knows its work will be scrutinized at some point by a competitor may have an increased incentive to ensure

[6] Ibid (pp. 7).
[7] Ibid (pp. 6).

that the audit is done correctly."[8] However, this argument requires the assumption that scrutiny provided by audit committee interactions and oversight; by new lead and concurring audit partners under the SEC's rules implementing SOX for mandatory partner rotation; by audit firm quality control processes, programs, and procedures (such as the multiple formal reviews by other members of the engagement team, including reviews by the lead and quality review partners, an engagement team's consideration of prior year audit work during audits in subsequent periods, audit firm internal inspection programs, national office interactions etc.); and by PCAOB inspections (and the deterrence effects of regulatory enforcement and private litigation) somehow do not offer adequate incentives.

Inchoate potentialities of skepticism combined with a lack of understanding of root causes do not meet the minimal thresholds of issuing a Concept Release or moving forward in consideration of it. By that token, as an example, anecdotal musings by the SEC, of ethical lapses by attorneys would not pass muster for regulatory action requiring law firm rotation by companies.

From the standpoint of evidence on the implications of auditor tenure, it is also important to recognize that the weight of the evidence from academic research does ***not*** support the implementation of mandatory audit firm rotation. Indeed, a recent review of the research literature finds that the evidence suggests several attributes of audit quality improve as auditor tenure increases.[9] Further, research on fraud by a member of both the PCAOB's Standing Advisory Group ("SAG") and Investor Advisory Group ("IAG") finds that fraudulent financial reporting is more likely to occur in the first three years of the audit-client relationship and fails to find any evidence that fraudulent financial reporting is more likely given long auditor tenure. Similar to other studies, this study concludes that the results are consistent with the

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[8] Ibid (pp. 17).

[9] For a review of academic research on mandatory audit firm rotation see "The Causes and Consequences of Auditor Switching: A Review of the Literature" by C. Stefaniak, J. Robertson, and R. Houston in *Journal of Accounting Literature* (Gainesville: 2009) Vol. 28: 47-122. The study acknowledges some evidence indicates that mandatory auditor rotation might improve audit quality in certain situations, although not without costs. Thus, even this evidence does not suggest convincingly that the benefits of mandatory auditor rotation will exceed its overall costs.

argument that mandatory audit firm rotation could have adverse effects on audit quality.[10]

The Concept Release attempts to dismiss dissenting evidence from academic research, in part, by arguing that skepticism is "unobservable," and therefore not susceptible to empirical study. This argument is circular reasoning at best. The academic literature is quite robust and the relevant evidence is obtained using multiple approaches and measures. The weight of the evidence is consistent with a lack of familiarity in early years as a problem, not over familiarity in later years. The Concept Release fails to rebut established research.

In addition, the Concept Release attempts to broadly dismiss all research evidence, nonconforming to the notion of mandatory audit firm rotation, as irrelevant because most of it is not based on a regime of mandatory audit firm rotation. According to the Concept Release, a limitation of the academic studies is that they "tend to focus on environments where auditor rotation is voluntary rather than mandatory." And, "voluntary rotation may be associated with auditor-issuer disagreements, other financial reporting, or economic issues."[11]

This argument fails to acknowledge that voluntary auditor changes involve disclosures and communications that should reveal potential problems to successor auditors (and investors) reducing the likelihood of subsequent audit failures. For the PCAOB to broadly dismiss the evidence begs the question of why the required communications and disclosures were somehow inadequate and contributed to audit failures after changes in auditors. This problem, if it exists, is one that the PCAOB can and should do something about rather than focusing on mandatory audit firm rotation.

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[10] For example, see "Audit Firm Tenure and Fraudulent Financial Reporting" by J. Carcello and A. Nagy in *Auditing: A Journal of Practice & Theory* (Sarasota: September 2004) Vol. 23 (2): 55- 70. Also, see two monographs in 1999 and 2010 from the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") using SEC Accounting and Auditing Enforcement Actions during 1987-1999 and 1998-2007 as a proxy for fraudulent financial reporting. The latter, *Fraudulent Financial Reporting 1999-2007* by M. Beasley, J. Carcello, D. Hermanson, and T. Neal, reported that 26% of fraud companies switched auditors between the issuance of the last clean financial statements and the last set of fraudulently misstated financial statements, as compared to 12% of no-fraud firms during the same time period (p. 37).

[11] Concept Release (pp. 16).

Finally, the CCMC is concerned about another way the Concept Release overreaches for evidence to support mandatory audit firm rotation. As stated earlier, an "audit failure" as argued by the PCAOB is in fact not an audit failure.

The PCAOB's misleading use of the term is evidenced by its comparison to the definition employed by the GAO in its 2003 surveys ("GAO Report") and report to Congress on the mandatory audit firm rotation concept. The GAO report defined the term as follows:

> ***"audit failure"*** *refers to audits for which audited financial statements filed with the SEC contained material misstatements whether due to errors or fraud, and reasonable third parties with knowledge of the relevant facts and circumstances would have concluded that the audit was not conducted in accordance with GAAS, and, therefore, the auditor failed to appropriately detect and/or deal with known material misstatements by (1) ensuring that appropriate adjustments, related disclosures, and other changes were made to the financial statements to prevent them from being materially misstated, (2) modifying the auditor's opinion on the financial statements if appropriate adjustments and other changes were not made, or (3) if warranted, resigning as the public company's auditor of record and reporting the reason for the resignation to the SEC.*[12]

Contrary to such an accepted definition, the Concept Release mischaracterizes findings in Part I of the PCAOB's inspection reports as audit failures. In turn, the PCAOB uses these audit failures as a "call to action." Yet, as the PCAOB well knows, the vast majority of inspection findings are not audit failures. For example, very few PCAOB inspection findings have given rise to restatements.

Instead, many of the findings described in Part I of the PCAOB's inspection reports involve differences of opinion between PCAOB inspectors and auditors over judgments on documentation and evidence acquisition. Frankly, a number of Part I inspection findings can be characterized as PCAOB inspectors' judgments that differ from auditors' judgments on managements' judgments. They are not audit failures. It is both misleading and unworthy of an audit regulator to characterize them as such to buttress a Concept Release.

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[12] GAO 04-217 *Public Accounting Firms Required Study on the Potential Effects of Mandatory Audit Firm Rotation* (2003) (pp. 6).

c. CIFiR Recommendations

Further, to improve audit quality related to auditor judgments, the CCMC has urged the PCAOB to adopt the recommendation of the SEC's Advisory Committee on Improvements to Financial Reporting (CIFiR).[13] In 2008, CIFiR recommended that the PCAOB develop and articulate guidance related to how the PCAOB inspections and enforcement divisions would evaluate the reasonableness of judgments made based on auditing standards. CIFiR also recommended that the PCAOB's statement of policy should acknowledge that the PCAOB would look to the SEC to the extent that the PCAOB would be evaluating the appropriateness of accounting judgments as part of an auditor's compliance with PCAOB auditing standards.

CIFiR also recommended that the concept of materiality be used as a determinative factor if mistakes in financial statements should trigger a restatement or simply further disclosure for investors. While the CIFiR recommendations were made in 2008, they still have not been acted upon.

d. Mandatory Audit Firm Rotation Would Be Costly and Disruptive to the Markets

As a supporter of effective audits, the CCMC believes a cost-benefit analysis is one effective approach to improving audit quality. In light of the weight of the academic research debunking mandatory audit firm rotation, it would seem that there is no net benefit for investors in moving forward in the consideration of the Concept Release.

As discussed earlier, mandatory audit firm rotation would be extremely costly and disruptive to the U.S. capital markets, harmful to investors and have far reaching negative consequences. The Concept Release acknowledges that mandatory audit firm rotation would disrupt markets and increase audit costs.[14] Likewise, the costs

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[13] For example, see letter to the PCAOB from the U.S. Chamber CCMC on *Concept Release on Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements and Related Amendments to PCAOB Standards* (PCAOB Release No. 2011-003, June 21, 2011, Rulemaking Docket Matter No. 34).

[14] Concept Release (pp. 3).

and disruptions arise from many sources and are largely unexplored in the Concept Release. Disruptions would extend to capital formation activities including initial public offerings and mergers and acquisitions. Mandatory audit firm rotation makes auditor choice and change a much more complicated proposition for companies and audit firms with interdependencies beyond the control of any particular party. Indeed, it is possible that overlaying mandatory audit firm rotation on top of all the many existing restrictions on audit choice would leave some large global companies without any available, eligible, requisite audit firm.

That would be a disaster for investors, companies, and capital formation with direct negative consequences for economic growth and job creation.

The Concept Release does note that the GAO Report includes an estimate that initial year audit costs—which includes costs beyond the audit fee itself— would increase by more than 20 percent with mandatory audit firm rotation.[15] However, this estimate was made before integrated audits of both the financial statements and internal control over financial reporting. It is likely that those costs would be higher today, in light of the additional reporting requirements imposed by post SOX legislation and regulations including the Dodd-Frank Wall Street Reform and Consumer Protection Act. Also, as stated earlier, research shows that there is an increase in costs and fraud potential during the first three years of a new auditor engagement.

Increases in costs associated with the audit process and potential fraud are just the tip of iceberg. For example, mandatory audit firm rotation would require company personnel and board/audit committee members to devote significantly more time and effort to the external audit function and activities in order to obtain the same results as now.

The Concept Release argues for overlaying mandatory audit firm rotation on top of the existing audit regulatory and governance structures that are already far-reaching and complex. However, the Concept Release provides no analysis of how mandatory audit firm rotation would even work under and interact with the existing structures.

[15] Ibid (pp. 14).

As just one example, the Concept Release provides no analysis of the implications of overlaying mandatory auditor rotation on top of a very rules-based system of auditor independence. The rules include the more visible ones that implement SOX provisions precluding certain non-audit services to audit clients and mandating audit partner rotation. Yet, there are many other less visible SEC and PCAOB independence rules that impact the hiring and retention of the audit firm and other accounting firms for non-audit services, as well as the hiring and retention of management, employees, and board members, too. As a result there are likely to be many companies, including those with large global operations, which will find themselves in the position of not being able to use any large audit firm as their external auditor.

An added complication is that audit firms are not fungible. As just one example, audit firms have differences in industry experience and expertise. Some firms have developed industry specializations. But, not even the larger audit firms specialize in all industries. It is not just a matter of severely altering and limiting audit firm choice from a company perspective. Mandatory rotation changes the ability of audit firms to develop and maintain expertise and complicates audit firm staff planning and allocation decisions, including geographically—all to the potential detriment of audit quality.

The Concept Release suggests that the PCAOB might consider precluding voluntary audit firm changes unless such changes are "for cause."[16] This is an untenable constraint on audit committees in their engagement of auditors and oversight of the audits. It naturally raises the question of what represents "for cause" and who decides. However, another problem is that preventing audit committees from dismissing an auditor at their discretion in this way actually reduces the amount of useful information available to investors. Voluntary auditor changes are informative to investors and other stakeholders in financial reporting. Eliminating this source of information by mandating audit firm rotation does not make investors better off.

Similarly, it should be noted that Congress, during the Dodd-Frank debates, considered and ultimately rejected a system whereby the SEC would assign credit

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[16] Ibid (pp. 23-24)

rating agencies to review companies or products. It would seem incongruous for the PCAOB then to consider a mechanism whereby it could either assign or withdraw a firm from engagement, again depriving the audit committee of its discretion and judgment.

The Concept Release asks for feedback on the PCAOB imposing mandatory audit firm rotation on some subset of public companies. For example, the Concept Release suggests the possibility of the PCAOB requiring mandatory audit firm rotation for the largest issuer audits, or audits of companies in certain industries.[17] But, the largest issuers are those where the problems with mandatory audit firm rotation would be most pronounced. Focusing on large issuers and companies in certain industries seems pointed towards large systemic risk institutions.

Given all the problems with mandatory audit firm rotation, mandating it for this subset would be akin to heightening systemic risk into the capital markets for systemically risky institutions. If this is the case, the management of systemic risk is left to the prudential regulators and the Financial Stability Oversight Council ("FSOC").

It seems that the Concept release is totally devoid of any consideration of the need of a cost benefit analysis. PCAOB standards must go through the SEC rulemaking process to be approved. The SEC must perform a cost benefit analysis in order to pass the appropriate legal muster in promulgating a regulation, *Business Roundtable & U.S. Chamber of Commerce v. Securities and Exchange Commission.* The SEC has also that it will comply with the Presidential Executive Orders 13563 and 13579 on regulatory reform.[18] These Executive Orders require an agency to choose the least burdensome means of imposing a regulation.

Therefore, it would seem prudent for these cost benefit issues to be addressed early in the process.

e. PCAOB Lacks Authority for Mandating Audit Firm Rotation

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[17] Ibid (pp. 3 and 21).

[18] See October 6, 2011 letter from U.S. Chamber of Commerce to the Securities and Exchange Commission on the process enhancements needed to comply with the Executive Orders.

As was noted earlier, the CCMC believes that SOX provides the SEC and not the PCAOB with authority over the operation of the audit committee.

The CCMC is concerned that mandating audit firm rotation exceeds the authority of the PCAOB. The CCMC appreciates that the Concept Release frames mandatory audit firm rotation as related to auditor independence and that auditor independence rulemaking falls within the purview of the PCAOB. However, this appears to be more of a convenience of form. In substance, mandatory audit firm rotation, including proscriptions on voluntary auditor change, would contravene audit committee responsibilities under SOX. Mandatory audit firm rotation would directly affect issuers and the status of issuer filings, which are under the purview of the SEC. As such, any requirements in this regard would need to be addressed by the SEC through Commission rulemaking and the SEC's due process.[19]

Finally, the CCMC is concerned that the Concept Release discusses the benefits of mandatory audit firm rotation "as a catalyst to introduce more dynamism and capacity into the audit market" as argued by the European Commission "Green Paper."[20] [21] The Concept Release goes on to explain that "if the largest firms were periodically displaced from their positions auditing the largest companies, more firms might develop additional capacity and expertise in order to compete for those engagements. If so, auditor choice would be increased."[22] Not only is this speculative, but it does not recognize the long timeframe over which any such emergence might occur or appreciate the severe discontinuities that would be encountered during the emergence process. More importantly, promoting competition is *not* the mission of the PCAOB. The PCAOB's mission focuses on maintaining and improving audit quality. Needless to say, the Concept Release does not further this mission either.

I. Conclusion

[19] It is inadequate to argue that the SEC must approve any rule adopted by the PCAOB before it can go into effect. The SEC rulemaking process is subject to requirements, including those related to transparency and cost-benefit analysis, which the PCAOB is not. Also, the Commission has delegated authority for approving certain PCAOB rules and standards to the Office of the Chief Accountant, where Commission action is required for SEC rulemaking.

[20] European Commission, *Audit Policy: Lessons from the Crisis* (October 2010).

[21] See also December 7, 2010 letter from the U.S. Chamber of Commerce to the European Commission with comments on the Green Paper.

[22] Concept Release (pp. 21).

The CCMC has serious concerns that the Concept Release will harm investors, adversely impact the competitiveness of American public companies and degrade audits in general. While we believe that improvements can be made to financial reporting, suggestions, ideas, and debates must be based upon hard facts, analysis and not on anecdotal information. The PCAOB is almost 10 years old and it is responsible for the system it has overseen, it is not a bystander that can simply opine pronouncements.

Public companies not only compete for capital internationally, but also against other conduits for investment return. The other competitors for capital include private equity, hedge funds, angel investing, venture capital, and debt instruments to name a few. Each of these venues of capital formation has its place and this variety is necessary for a fully functioning 21st century economy. However, the sharp amount of de-listings indicate that public companies are not able to compete for capital as they once did and there is an adverse economic consequence for us all as a result. The notion of mandatory audit firm rotation will not stem that tide, it will only exacerbate it.

The PCAOB has failed to answer questions or presented factual evidence that would justify the issuance of the Concept Release. As we should all work together to provide a sound basis for a strong capital market system that must create the 20 million jobs needed to recover economically and restore prosperity, this is the wrong idea at the wrong time and it should not only be rejected, it should be withdrawn.

Sincerely,

Tom Quaadman