American Federation of Labor and Congress of Industrial Organizations

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June 25, 2012

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

Re: Proposed Auditing Standard on Related Parties, Amendments to Certain PCAOB Auditing Standards Regarding Significant Unusual Transactions and Other Proposed Amendments to PCAOB Auditing Standards

Dear Mr. Seymour:

On behalf of the American Federation of Labor and Congress of Industrial Organizations ("AFL-CIO"), I appreciate the opportunity to comment on proposed amendments to the Public Company Accounting Oversight Board ("PCAOB") auditing standards. The AFL-CIO is the largest labor federation in the United States and represents more than 12 million union members. Union-sponsored pension and employee benefit plans hold more than $480 billion in assets.

The AFL-CIO supports the proposed amendments to Auditing Standard No. 12, Identifying and Assessing Risk of Material Misstatement. We agree with PCAOB Chairman James Doty that the proposed amendments will "sharpen auditors' focus and help them be more effective in their investor protection role," and "enhance the auditors' understanding of the issuers' financial arrangements with its senior officers."[1]

The proposed changes use a common sense approach to strengthen the auditors' ability to evaluate the relationship between executive compensation, risk, and financial misstatements. The desire to increase management compensation based on financial results is one of the most commonly cited motivations for fraud, according to a recent study commissioned by the Committee of Sponsoring Organizations of the Treadway Commission. The study notes that

[1] Comments at PCAOB Open Board Meeting, Feb. 28, 2012.

either the chief executive officer or the chief financial officer was associated with financial statement fraud in 89 percent of cases.[2]

We support the proposed amendments to Auditing Standard 12 that will require the auditors to perform certain procedures, including examining employment and compensation contracts as well as the proxy statement and other relevant company filings with the Securities and Exchange Commission, to evaluate the impact of incentive compensation arrangements on the risk of financial misstatement. Because the board of directors is ultimately responsible for setting senior executive compensation, we also support requiring auditors to inquire of the chair of the compensation committee, and any compensation consultants engaged, about the structure of executive compensation.

These proposed changes are incremental and build on what is already required under Statement on Auditing Standards 99: Consideration of Fraud. SAS 99 requires auditors to scrutinize any incentives for fraud, including compensation. We suggest that the PCAOB clarify the specific information auditors should seek from board compensation committees and compensation consultants regarding executive compensation arrangements. Auditors should, in particular, pay careful attention to executive compensation that includes a heavy reliance on asymmetric incentive structures such as stock option compensation that might encourage executives to swing for the fences.

Some have argued that the proposed changes will improperly inject auditors into the executive compensation process, and that companies may have their business judgment second-guessed by their auditors. We believe these arguments lack merit for two reasons. First, current auditing standards already require auditors to gain an understanding of executive compensation arrangements—the only difference between the current standard and the proposed changes is how auditors should gain that understanding. Second, these changes will result in better audits and better internal controls that ultimately benefit both the company and investors.

We appreciate the opportunity to share our views with the PCAOB. If you need any additional information, please contact me at 202-637-3900.

Sincerely,

Brandon Rees
Acting Director
AFL-CIO Office of Investment

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[2] "Fraudulent Financial Reporting 1998-2007: An Analysis of U.S. Public Companies," by Mark S. Beasley, Joseph V. Carcello, Dana R. Hermanson and Terry L. Neal, 2010.