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Via e-mail: comments@pcaobus.org

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

Re: PCAOB Release No. 2011-007, Rulemaking Docket Matter No. 029,
Improving the Transparency of Audits: Proposed Amendments to PCAOB Auditing Standards and Form 2

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

BDO USA, LLP welcomes the opportunity to comment on the Public Company Accounting Oversight Board's (the PCAOB or Board) Release No. 2011-007, *Improving the Transparency of Audits: Proposed Amendments to PCAOB Auditing Standards and Form 2* (the Release). We recognize the need to increase transparency about the audit process, particularly as it relates to promoting the performance of high quality audits, and we are committed to actively participating in efforts to enhance audit performance. We believe that many of the recent efforts initiated by the PCAOB, including changes to the auditor's report and enhanced audit committee communications, support such transparency.

The Board explains in the Release that inspections show that there is still significant room for improvement in complying with PCAOB auditing standards and that disclosing the name of the engagement partner may be one means of promoting better performance. As noted in our comment letter dated December 14, 2011, regarding PCAOB Release No. 2011-006, *Auditor Independence and Audit Firm Rotation*, we share the Board's concern regarding the frequency and types of audit deficiencies found during inspections. However, while we are committed to the performance of high quality audits, we believe that understanding the root causes of these deficiencies and addressing them with targeted responses is the best way to improve audit quality. In contrast, we do not believe that disclosing the name of the engagement partner will achieve this objective and may carry with it certain unintended consequences.

We also have continuing concerns about the potential impact of the Release on the liability of the engagement partner under the Securities laws and other legal regimes. We are also concerned about any incremental liability that may be taken on by identification in the audit report of other firms/participants in the audit. Accordingly, we believe it is important for the PCAOB to perform a complete analysis of these implications.

With respect to disclosure of other firms/participants in the audit, while we understand that more information about the composition of the cadre of audit resources may be useful to investors, we are concerned that it could detract from the perception of the principal auditor's primary responsibility for the overall audit. If this part of the Release is adopted,



however, we suggest alternative disclosure thresholds that we believe are more practical than those proposed, but which should still satisfy investor needs.

Our views on the main areas covered by the Release are provided within the sections below, with a reference to the relevant questions posed by the Release shown parenthetically, where applicable.

Disclosure of the Name of the Engagement Partner

We do not believe that audit quality would be improved in a meaningful way through disclosure of the name of the engagement partner. We understand that some stakeholders believe that such disclosure would improve audit quality by increasing the engagement partner's sense of accountability so that greater care would be taken in performing the audit. As described below, we believe that there is already a sufficient level of accountability in the existing environment, obviating the need for engagement partner identification. Moreover, any such disclosure in the audit report could have unintended consequences.

Engagement Partner Accountability (questions 1-3)

As stated in our comment letter to the 2009 PCAOB request for public comment on the *Concept Release on Requiring the Engagement Partner to Sign the Audit Report*, we believe that engagement partners are already keenly aware of their responsibilities and accountability. In our view, disclosure of the name of the engagement partner would not have an impact on engagement partners' accountability because, as described below, they are already held accountable to multiple external parties, including regulators, investors, and audit committees, in addition to the audit firm.

(a) PCAOB and SEC

The PCAOB performs inspections to evaluate the sufficiency of a firm's quality control system and the performance on individual audit engagements. Further, engagement partners are also subject to enforcement actions by the PCAOB and SEC, which can significantly impact the careers of engagement partners and are visible to the public. Determinations of improper professional conduct can lead to various penalties, including barring an individual from practicing before those bodies.

(b) Investors

There are various mechanisms under the law for investors to bring legal action against engagement partners if there is a perceived audit failure. The potential for litigation is a substantial incentive to maintain audit quality and a clear and strong reminder to engagement partners of their accountability.



(c) Audit committees

Acting on behalf of investors and other stakeholders, audit committees provide oversight over the audit process. Under the Sarbanes-Oxley Act of 2002, audit committees are responsible for the appointment, compensation and oversight of the auditor, and for pre-approving all audit and non-audit services provided by the audit firm. Engagement partners have frequent interactions with audit committees on substantive audit issues where they may be subject to probing questions and ultimately to evaluation by the audit committee, which is indicative of this line of accountability.

(d) The audit firm

Through their systems of quality control, audit firms are required to monitor and evaluate the quality of engagement partners, as follows:

- Development of engagement partner competence and authority to perform the role;
- Performance evaluations and compensation structures that appropriately recognize and reward technical competence, professionalism, and commitment to ethical principles and take action when performance is lacking. Any PCAOB inspection findings would ordinarily be an important part of the evaluation process;
- Engagement quality reviews to evaluate the significant judgments made and conclusions reached in forming an overall conclusion on the engagement; and
- National office oversight of engagement performance through technical consultations or otherwise.

This direct line of accountability of the partner to the firm is embedded in day to day activities of the partner.

Potential Liability
(questions 7-9)

We appreciate the Board's change from the Concept Release in no longer providing for the signature of the engagement partner in the audit report. However, we believe that even disclosure of the name of the engagement partner in the audit report has the potential to increase liability risk under Section 11 of the Securities Act of 1933 (Section 11) and Section 10(b) and Rule 10-b(5) of the Securities Exchange Act of 1934 (Section 10). Accordingly, we believe that the Board should perform a full assessment of the impact of these proposed amendments on engagement partner liability before concluding on the appropriateness of the proposals.

We are concerned that disclosing the name of the engagement partner within the audit report may require the engagement partner to file a consent pursuant to Section 7 of the Securities Act of 1933 and Rule 436, which would trigger Section 11 liability. Accordingly, we suggest that the PCAOB work with the SEC to clarify that any disclosure requirement



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would meet the objective of the Release of not increasing the engagement partner's liability under Section 11 and that consent pursuant to Section 7 and Rule 436 for engagement partners is not required.

With respect to Section 10(b) liability, while we understand that the United States Supreme Court has clarified what must be shown to prove that an individual or firm made an untrue statement of a material fact in violation of Section 10(b) and 17 C.F.R. § 240.10b-5 (Rule 10b-5)¹, it is uncertain how lower courts will apply the Court's ruling to engagement partners, so claims under Section 11 may nevertheless be asserted against them. The costs to defend against any such claims, even meritless ones, are potentially significant and defending such personal lawsuits would be highly disruptive to the daily business of engagement partners. Taking a partner out of the practice while defending a lawsuit would be extremely expensive and ultimately increase the costs of providing audits.

In addition to our concerns about increased liability risk as it relates to disclosure of the name of the engagement partner, we are also concerned about increased liability risk as it relates to disclosure of other participants in the audit.

For these reasons, we recommend that the Board conduct a thorough legal analysis before considering adoption of any of the proposed amendments relating to identification of the engagement partner.

Proposed Amendment to Form 2 to Disclose Name of Engagement Partner (questions 11-13, and 15)

As discussed above, we do not believe that disclosure of the name of the engagement partner will increase the partner's sense of accountability and resulting audit quality. However, if the Board nevertheless concludes that such identification will be required, we believe that disclosure within Form 2 is preferable to disclosure within the audit report. Disclosure of the engagement partner name in both the audit report and Form 2 would be redundant and, therefore, unnecessary. As noted in the Release, the use of Form 2 provides a convenient mechanism to retrieve information about a firm's engagement partners for all of its audits. Additionally, such an approach provides for consistency in the manner of reporting such that investors can easily ascertain the names of the engagement partners for any audit reports issued during the reporting period. Further, disclosing the name of the engagement partner solely in Form 2 may help to alleviate the concerns we noted above relating to engagement partner liability.

In addition to disclosure of the name of the engagement partner on Form 2, the Release requests comment on whether firms should be required to file a special report on Form 3 whenever there is a change in engagement partners before the end of the mandatory

¹ The U.S. Supreme Court issued its decision in *Janus Capital Group, Inc. v. First Derivative Traders* in June 2011. This decision addressed what it meant to "make any untrue statement of material fact" under Section 10(b) and Rule 10b-5(b), which was held to mean, for the purposes of Rule 10b-5, that the maker of a statement is the person or entity with ultimate authority over the statement, including its content and whether and how to communicate it.



rotation period, to explain the reasons for the change. We do not believe that such additional reporting would be necessary given the proposed amendments to Form 2 that provide for disclosure of the name of the engagement partner for each audit performed by a firm during the annual reporting period. Moreover, disclosure of such changes without disclosing the reasons could create market uncertainty, while disclosure of changes precipitated by personal matters unrelated to audit quality would be overly intrusive.

Disclosure of Other Participants in the Audit
(questions 16-21)

The Release would require disclosure in the audit report of the names, locations, and extent of participation of other independent public accounting firms, and other persons not employed by the auditor, that took part in the most recent period's audit when the auditor assumes responsibility for or supervises their work. As previously stated in our letter, while we understand that more information about the composition of the cadre of audit resources may be useful to investors, we are concerned that it could detract from the investors' perception of the principal auditor's responsibility for overseeing the audit. However, we have provided our views on this element of the Release in the event that the Board decides to proceed with the recommendations.

We agree that it is appropriate to not require disclosure of (1) individuals performing the engagement quality review, (2) persons with specialized skill or knowledge in a field other than accounting or auditing, (3) persons employed or engaged by the company who provided direct assistance to the auditor, or (4) off-shore arrangements to the extent that that work is performed by another office of the same accounting firm (even though that office may be located in a country different from the country where the firm is headquartered).

Our concerns regarding the increased liability risk as it relates to other participants are included within the preceding section entitled *Potential Liability*, beginning on page 3.

Measurement Criteria for Disclosure and Nature of Disclosure
(questions 25-28)

The Release suggests that the most appropriate quantitative measure of the other participants' relative participation in the audit is the percentage of total hours in the most recent period's audit, excluding the hours for engagement quality and Appendix K reviews. While this measurement criterion is likely the most appropriate and the data easily obtainable by engagement teams, we believe there are certain implementation issues that should be considered before establishing such a requirement. This includes determining the appropriate audit hours to use when audit work serves two purposes (e.g., when there is some overlap between work performed on statutory audits of subsidiaries pursuant to foreign laws and that used in connection with the group audit of the issuer).

The Release also asks if a discussion of the nature of the work performed by other participants in the audit should be required. We do not believe that such disclosure would be helpful without providing the context within which such work was performed, which would be difficult to summarize in a meaningful way. To put such description in the proper



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context would require significant amount of background and other information pertinent to the conduct of an audit, and would generally not be well understood by users of the financial statements not expert in the performance of an audit. Providing such information would therefore run the risk of being extremely lengthy and potentially misleading.

Threshold for Disclosure
(question 31)

The Release explains that the Board's intention in proposing a 3% threshold for disclosing other participants in the audit is to provide investors and other users of the financial statements with the most meaningful information about participants in the audit. However, we believe that a 3% threshold is too low and, in that regard, suggest that it instead be set at 10% or 20%, as these percentages are consistent with disclosures for material matters required by other regulatory and standard setting bodies, such as those relating to segment reporting (10%) and for determining what constitutes a "substantial role" under the PCAOB registration rules (20%). A higher than 3% threshold would also be consistent with views mentioned by some investor and issuer members of the Standing Advisory Group at its November 2011 meeting.

Once an appropriate threshold is established, we also believe it would be appropriate to provide such disclosures within ranges (e.g., firms between 10%-20%, 20%-40%, etc.). The use of ranges would simplify reporting and alleviate any concerns about the precision of estimates that would need to be made in determining the extent of participation.

We appreciate the opportunity to comment on the Release and are available to answer any questions you may have regarding our views. Please direct any questions to Chris Smith, Audit and Accounting Professional Practice Leader, at 310-557-8549 (chsmith@bdo.com) or Susan Lister, National Director of Auditing, at 212-885-8375 (slister@bdo.com).

Very truly yours,

/s/ BDO USA, LLP

BDO USA, LLP