



Ernst & Young LLP
5 Times Square Office
5 Times Square
New York NY 10036

Tel: +1 212.773.3000
ey.com

Phoebe W. Brown, Secretary
Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, DC 20006-2803

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**PCAOB Rulemaking Docket Matter No. 029
Supplemental Request for Comment: Rules to Require Disclosure of
Certain Audit Participants on a New PCAOB Form**

Dear Ms. Brown:

Ernst & Young LLP (EY) is pleased to provide our views on the *Supplemental Request for Comment: Rules to Require Disclosure of Certain Audit Participants on a New PCAOB Form* (the Supplemental Request or the Proposal) issued by the Public Company Accounting Oversight Board (PCAOB or Board). Our global organization, Ernst & Young Global Limited, joins in these comments.

We appreciate the efforts the PCAOB has made to take into account the concerns and viewpoints of a variety of stakeholders, particularly concerns surrounding the significant legal and practical challenges that would be created by requiring the identification of the engagement partner and other audit participants in the auditor's report. While we continue to believe disclosures about the audit should focus on firm-wide accountability and not on specific individuals, the PCAOB's proposed use of Form AP is a much improved approach.

Accordingly, our comments below focus primarily on areas where we believe use of Form AP and the related filing process might be improved or made more practical. Such comments relate to the timing, completeness, consistency and accuracy of the disclosures.

Identification of audit participants in the auditor's report

As the Board is aware, our firm and many other commenters have expressed a view that including the names of the engagement partner and other audit participants within the audit report could impede capital formation. Providing such information in the audit report would create the need to obtain a consent of those named in securities filings, and would trigger potential liability under Section 11 of the Securities Act of 1933. Such effects would increase the cost and time required for companies to access the capital markets.

The Board has addressed these concerns in the Supplemental Request through the advancement of the Form AP alternative. Concern with potential liability under Section 10(b) and Rule 10b-5 of the Securities Exchange Act as expressed in prior comments would remain, but we nonetheless believe that the new approach is a significant improvement.

Identification of other participants in the audit

The Board's previous releases on PCAOB Rulemaking Docket Matter No. 29 included various proposals for the disclosure of other participants who performed audit procedures in the audit in order to provide transparency when the auditor assumes responsibility for or supervises the work of another individual or entity. In our previous comment letters we expressed support for these disclosures suggesting they would provide meaningful and useful information to investors (provided that such disclosures did not appear in the auditor's report).

There are, however, several actions the PCAOB might consider to promote the disclosure of meaningful and consistent information without increasing the complexity and costs of providing this information. These actions are: (a) providing guidance to promote consistent and accurate disclosures about other audit participants; (b) considering how a network or firm's legal structure might affect disclosure and (c) addressing the timing of reporting on Form AP.

In addition to these three key points, we urge consideration of the potential for an unintended consequence whereby the auditor might report information about the location of the issuer's operations in foreign jurisdictions that the issuer may not itself disclose in SEC filings. As a result, the auditor could be the only source of information about the location of the issuer's operations based on the level of audit effort and the disclosures in Form AP.¹

Providing guidance to promote consistent and accurate disclosures about other audit participants

Although a disclosure requirement for other audit participants based on audit hours may seem straightforward, there are a number of factors that might affect the consistency and accuracy of this information that we believe warrant further consideration by the Board.

In most countries outside the United States, local regulations require an audit of each separate legal entity within that local jurisdiction. For large multinationals, there might be numerous statutory entities that comprise an accounting unit that is in the scope of the consolidated or

¹ For example, the Form AP could disclose significant audit effort in Country X because it is in the scope of the audit. However, the issuer does not disclose operations in Country X because those operations are aggregated with those of Country Y and Z and disclosed as a single segment.

group audit. The group auditor might use some of the work performed by the statutory auditor in order to avoid duplication of audit efforts.

For example, the group auditor might request another auditor to perform procedures on inventory and the related controls over inventory - procedures that are also required for the statutory audits. The statutory audit work is likely to be much more substantial than what is needed for purposes of the group audit, because the materiality thresholds for statutory audits are likely to be much lower. In this example, the results of inventory testing for the statutory audits are reported back to the group auditor using the higher materiality thresholds set by the group auditor. However, the other auditor does not separately track the hours it would have taken to perform the inventory procedures at a higher materiality threshold set by the group auditor and it is not practical to do so.

For most multinational audits where a group auditor is relying on the work of the statutory auditor, the ability to distinguish between statutory audit hours that were necessary for the group audit and those that were not will require significant estimates and judgments. Without further guidance from the PCAOB, or use of an alternative, there is the potential for significant variance in methodology employed by firms that could raise concerns about consistency and comparability of the data reported.

Because of the inability to distinguish between statutory audit hours that are necessary for the group audit and those required only for statutory purposes, we believe allocation estimates will be made, which may vary widely based on differing assumptions, or that total statutory hours will be included in the calculation for entities in the scope of the group audit. One solution would be for the Board to make clear its expectations in this area, in order to avoid inconsistencies in how information about other participants is reported on Form AP.

An alternative solution would permit disclosure of other audit participants using fees as the metric rather than hours for those entities that are included in the audit scope of the issuer. SEC proxy rules require disclosure of the aggregate fees billed for each of the last two fiscal years for professional services rendered by the principal accountant for audits and reviews and for services that are normally provided by the accountant for statutory and regulatory filings or engagements for those fiscal years.²

Fee information for entities that are in the scope of the audit could be used as the basis for disclosure without the need for making estimates or use of methodologies that vary by firm.

² SEC Form 10-K, Part III, Item 14

Information about fees paid to other audit participants is readily available and is already required to be aggregated and disclosed.

We understand that as part of its deliberations on the 2013 Proposal the Board considered audit fees incurred for other participants in the audit as a percentage of audit fees in the issuer's proxy disclosure but concluded that this measure may not be representative of the extent of other participants' participation in the audit.³ Using fees for entities within the scope of the audit would limit the focus to only those participants whose audit effort benefited the group audit and avoid the costs of gathering hourly information that might not be readily available. For these reasons, we believe the Proposal will be improved by the Board's reconsideration of this modified approach.

Under either of the approaches outlined above there is the potential for over-reporting of the level of effort by other audit participants. Since the circumstances of each audit will vary, to promote greater consistency in the reporting on Form AP we believe that the PCAOB should allow firms to report based upon (1) statutory audit time for entities in the scope of the group audit⁴ or (2) audit fees paid to other participants for entities in scope of the audit⁵.

Considering how a network or firm's legal structure might affect disclosure

The organizational structures of the larger firms' global networks vary widely. Under the rules proposed in the Supplemental Request, the legal structure of each global network and member firms would cause variation in how information is presented in Form AP, thereby significantly affecting the comparability and usefulness of the information.

³ PCAOB Release No. 2013-009, December 4, 2013, page A3-16.

⁴ For example, the calculation might be as follows. Assume the total audit time including all statutory audits is 10,000 hours, including 1,000 hours for statutory audits of entities not in the scope of the group audit and 2,000 hours for statutory audits of entities that are included in the scope of the group audit. For purposes of determining the disclosure on Form AP, the calculation would be 2,000 hours divided by 9,000 hours or within the range of 20-30%.

⁵ For example, the calculation might be as follows. Assume the total Audit Fees disclosed under SEC Form 10-K, Part III, Item 14 (1) is \$1,000,000, including \$50,000 of fees for audits of other entities by other participants that are not in the scope of the group audit and \$150,000 of fees for other participants in the audit of entities that are included in the scope of the group audit. For purposes of determining the disclosure on Form AP, the calculation would be \$150,000 divided by \$950,000 or within the range of 10-20%.

Unlike the proposed amendments issued in 2013, the Supplemental Request would not require disclosure of non-accounting firm participants in the audit.⁶ In many jurisdictions, it is common for certain audit participants to be employees of a legal entity within the global network that is not a public accounting firm under the PCAOB's definition. For example, tax practitioners operating in a separate legal entity that does not meet the definition of a public accounting firm might provide significant services in the conduct of a group audit; under the Supplemental Request, their participation in the audit would not be disclosed on Form AP. Similarly, some firms have an offshore service center whose employees provide assistance in executing routine audit procedures. Whether these centers are housed within a legal entity that meets the definition of an accounting firm may vary among firm networks, thereby leading to variations in Form AP disclosures under the proposed Supplemental Request.

The Supplemental Request states that the Board is considering a "more tailored approach"⁷ under which no disclosure as an "other audit participant" would be required for entities that are "controlled" by the registered firm. The fact that the primary audit firm controls the operations of another audit participant does not necessarily change the amount of supervision and review that is required for audit procedures undertaken by that entity. As a result, this alternative does not appear to address one of the primary objectives of the disclosure.

Because the legal structure underlying other audit participants will affect the disclosure in Form AP and affect the meaningfulness of the information, we urge the Board to consider requiring disclosure of any entity within a global network of firms that participates in the audit and meets the extent of participation criteria set forth in the proposed Form AP.

Addressing timing of reporting on Form AP

The Supplemental Request states that the Board is considering a filing deadline of 30 days after the date the auditor's report is first included in a document filed with the SEC, with a shorter deadline of 10 days for initial public offerings ("IPOs"). Several registered accounting firms (including EY) have well in excess of 1,000 issuers and broker dealers that would require

⁶ PCAOB Rule 1001(p)(iii) defines the term "public accounting firm" to mean "a proprietorship, partnership, incorporated association, corporation, limited liability company, limited liability partnership, or other legal entity that is engaged in the practice of public accounting or preparing or issuing audit reports."

⁷ Under this more tailored approach, disclosure of certain information about non-accounting firm participants in the audit could be required if, in the current period, the auditor was required to supervise other persons that are not: (1) other accounting firms; (2) the auditor's own employees; or (3) entities that are controlled by or are under common control with the auditor, or employees of such entities. Control could be defined for that purpose as the power to direct or cause the direction of management and policies of the participant, whether through the ownership of voting securities, by contract, or otherwise.

reporting on Form AP. Since filing dates for issuers' annual reports vary throughout the year, the proposal could require an accounting firm to make multiple filings on Form AP with the PCAOB daily. To reduce the administrative burden and cost, we believe the PCAOB should consider an alternate time and reporting format that would still allow users of the information to receive the information for use in conjunction with annual shareholder meetings and proxy voting.

Specifically, as it relates to the proposed 30 day requirement, investor commenters on PCAOB Rulemaking Docket Matter No. 29 have indicated that they seek the information required on Form AP in connection with their oversight and voting responsibilities as shareholders. Therefore the PCAOB might consider requiring the information on a similar timeframe as information required by Part III of Form 10-K.⁸ Part III information is to be incorporated by reference from the definitive proxy or information statement or by amendment no later than 120 days after the year-end of the registrant. A 120 day filing requirement after the Issuer's year end for filing the Form AP also would coincide with the availability and use of proxy fee information as the basis for disclosure in Form AP of other audit participants as suggested above⁹.

Because of potential delays in public filings by issuers, and the need to address the filing requirements of Foreign Private Issuers and issuers that are non-accelerated filers, we suggest that at a minimum the information not be required sooner than the required completion date of the audit work papers prescribed in Auditing Standard No. 3, *Audit Documentation* (AS 3), which is 45 days after the auditor's report release date. During this period, auditors would be completing audit documentation and incurring additional hours. Using the completion date of the audit work papers as the basis for a filing deadline would also obviate the need for estimates to be made at the report release date, as would be the case under the Supplemental Request. A reasonable period of time after this 45 day period, such as 15 days, would allow auditors to complete their work and provide the required information on Form AP with all hours reflected in the audit effort. Therefore, we suggest that the final rule indicate that the Form AP is due within 120 days after year-end or 60 days after the report release date, whichever is later.

⁸ Item III of Form 10-K requires information required by Items 10-14 of the Form (Item 10, *Directors, Executive Officers and Corporate Governance*; Item 11, *Executive Compensation*; Item 12, *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters*; Item 13, *Certain Relationships and Related Transactions, and Director Independence*; and Item 14, *Principal Accountant Fees and Services*). This information is generally incorporated by reference from the registrant's definitive proxy statement or definitive information statement which involves the election of directors.

⁹ Using a 120 day period means that auditors would have to file the Form AP for large accelerated filer issuers 60 days after the due date of the Form 10-K. If the 120 day period is used for non-accelerated filers, the Form AP would be due within 30 days after the due date of the issuer's Form 10-K.



Additional comment

Recognizing the SEC is currently soliciting comments on Concept Release No. 33-9862, *Possible Revisions to Audit Committee Disclosures*, (Concept Release), we encourage the continued coordination by the PCAOB and the SEC as many of the suggestions above regarding the content of Form AP relate to the content and timing of the proxy disclosures under consideration in the Concept Release.

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We want to thank the Board for its consideration of this letter and the comments we previously submitted on this topic. We would be pleased to discuss our comments with members of the Board or its staff.

Respectfully submitted,

Attachment

Copy to: PCAOB
James R. Doty, Chairman
Lewis H. Ferguson, Board Member
Jeanette M. Franzel, Board Member
Jay D. Hanson, Board Member
Steven B. Harris, Board Member
Martin F. Baumann, Chief Auditor

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