

COUNCIL OF INSTITUTIONAL INVESTORS

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Via Email

February 2, 2009

Office of the Secretary
PCAOB
1666 K Street, NW
Washington, DC 20006

Re: PCAOB Rulemaking Docket Matter No. 027

Dear Mr. Seymour:

I am writing on behalf of the Council of Institutional Investors (“Council”) in response to the Public Company Accounting Oversight Board’s (“PCAOB” or “Board”) “Rule Amendments Concerning the Timing of Certain Inspections of Non-U.S. Firms, and Other Issues Relating to Inspections of Non-U.S. Firms” (“Release”).¹ We appreciate the opportunity to provide our comments on the Release.

The Council is a nonprofit association of more than 140 public, union and corporate pension funds with combined assets that exceed \$3 trillion. Our member funds have fiduciary obligations to the millions of Americans whose retirement savings are invested through them.² Accordingly, the Council seeks to address investment issues that affect the size or security of plan assets.

As major long-term shareowners, the Council’s members have a keen interest in the health and integrity of the global capital market system. That interest is reflected in the Council’s policies that express our belief that “the efficiency of global markets—and the well-being of the investors who entrust their financial present and future to those markets—depends, in significant part, on the quality, comparability and reliability of the information provided by *audited* financial statements and disclosures.”³ That interest is also reflected in the Council’s long-standing public support of the PCAOB and its vital role in restoring confidence of the investing public in financial reporting.⁴

¹ Rule Amendments Concerning the Timing of Certain Inspections of Non-U.S. Firms, and Other Issues Relating to Inspections of Non-U.S. Firms 1 (proposed Dec. 4, 2008) [hereinafter *Release*], http://www.pcaobus.org/Rules/Docket_027/2008-12-04_Release_No_2008-007.pdf.

² Additional information about the Council of Institutional Investors (“Council”) and its members is available at <http://www.cii.org/about>.

³ Council Policies on Other Governance Issues, Independence of Accounting and Auditing Standard Setters 1 (updated Oct. 7, 2008) (emphasis added), [http://www.cii.org/UserFiles/file/council%20policies/CII%20Policies%20on%20Accounting%20and%20Auditing%2010-7-08\(1\).pdf](http://www.cii.org/UserFiles/file/council%20policies/CII%20Policies%20on%20Accounting%20and%20Auditing%2010-7-08(1).pdf).

⁴ See, e.g., Brief of Amicus Curiae Council in Support of Defendants-Appellees & Urging Affirmance at 1, *Free Enter. Fund v. PCAOB*, No. 07-5127 (D.C. Cir. Feb. 21, 2008) (on file with Council), available at <http://law.du.edu/images/uploads/corporate-governance/fef-pcaob-amicus-cii.pdf>.

In fulfilling its responsibilities to investors, perhaps the most important function of the PCAOB is its inspections of registered firms. Those inspections not only involve reviewing auditors for technical compliance of standards, but delve into the broader business context of a firm's audit practices and influences on those practices.

In our view, regular and rigorous inspections by the PCAOB of U.S. and non-U.S. registered firms is critical to improving the odds of detecting violations of auditing standards, auditor-independence rules, and other substandard audit practices and influences.⁵ Without prompt detection and correction of audit issues of concern, the issues may metastasize into major problems that unnecessarily corrode investor confidence and impair the efficient operation of the capital market system.⁶ It is on this basis that we address the following specific matters raised by the Release.

Extension of Deadline for Inspections

Given our aforementioned view of the importance of *regular* and rigorous inspections by the PCAOB of U.S. and non-U.S. registered firms, we obviously have great concern with the Release's proposal to "allow the Board to postpone, for up to three years, the first inspection of any non-U.S. firm that the Board is currently required to conduct by the end of 2009 and that is in a jurisdiction where the Board has not conducted an inspection before 2009."⁷ Our concern has only grown in recent weeks with the daily press reports about Satyam Computer Services Ltd. accounting scandal and related allegations that the PCAOB inspection process has "gaping holes."⁸ Our concern, however, is somewhat tempered by the comments of Board Member Charles D. Niemeier that the extension "allow us to do a better inspection in the end" by using the deferral period to improve certain aspects of the inspection process.⁹ Our support for this proposal is, therefore, contingent on the final rule including or being accompanied by, at a minimum, the following conditions to ensure that the quality of the Board's inspections of U.S. and non-U.S. registered firms becomes "better" and more responsive to the needs of investors going forward:

- The scope of the final rule does not extend beyond the proposed "subset of first-time inspections" and the length of the extension does not extend beyond the proposed three-year period.¹⁰
- The final rule is accompanied by a commitment by the Board to prominently and conspicuously disclose on the PCAOB website:
 - A list of all registered firms that have not yet been inspected by the PCAOB under the Board's original timeframe.¹¹

⁵ *Id.* at 19.

⁶ *Id.* at 20.

⁷ *Release, supra* note 1, at 10-11.

⁸ Subramaniam Sharma et al., *India's Enron Puts Auditors Back Under Scrutiny*, Bloomberg.com, Jan. 13, 2009, at 1, http://www.bloomberg.com/apps/news?pid=20601109&sid=aov_laRpSmno&refer=home.

⁹ Statement of Board Member Charles D. Niemeier, Open Board Meeting To Consider a Recommendation to Adopt an Amendment to Rule 4003 as it Applies to Certain Non-U.S. Registered Public Accounting Firms, and Seek Public Comment on Other Proposals Also Related to the Inspections of Non-U.S. Firms 1 (Dec. 4, 2008) [hereinafter *Niemeier*], http://www.pcaobus.org/News_and_Events/Events/2008/Speech/12-04_Niemeier.aspx.

¹⁰ See Statement of Chairman Mark W. Olson, Open Board Meeting to Consider a Recommendation to Adopt an Amendment to Rule 4003 As It Applies to Certain Non-US Registered Public Accounting Firms, and Seek Public Comment on Other Proposals Also Related to the Inspections of Non-US Firms 1 (Dec. 4, 2008), http://www.pcaobus.org/News_and_Events/Events/2008/Speech/12-04_Olson.aspx.

¹¹ See Statement of Board Member Daniel L. Goelzer, Amendments Concerning the Timing of Certain Inspections of Non-U.S. Firms and Other Issues Related to Inspections of Non-U.S. Firms 1 (Dec. 4, 2008) [Hereinafter *Goelzer*], http://www.pcaobus.org/News_and_Events/Events/2008/Speech/12-04_Goelzer.aspx; Statement of Board

- A list of the countries in which PCAOB inspections will be performed in the next twelve months¹²
- The final rule is accompanied by a Board directive to the PCAOB inspection division to promptly develop and implement a strategy to:
 - Begin inspecting those non-U.S. firms whose inspections have been deferred under the final rule based on the total market capitalization schedule described in the Release and adjusted on an ongoing basis for the presence of any risk factors that the Board believes are appropriate to consider in protecting investors¹³
 - Evaluate quality control functions in the context of local non-U.S. inspections¹⁴
 - Evaluate the “substantial risk that referred work on multi-national audits presents” to investors,¹⁵ and
- The final rule is accompanied by a Board directive to the PCAOB Office of Research and Analysis to promptly develop and implement a strategy for providing planning advice for non-U.S. firm inspections consistent with the existing practice of providing such advice for U.S. firm inspections.¹⁶

Transparency Concerning Delayed Inspections

As previously indicated, we support the Board’s proposed practice, described in the Release, to maintain “on its web site an up-to-date list of all registered firms that have not yet had their first Board inspection even though more than four years have passed since the end of the calendar year in which they first issued an audit report while registered with the Board.”¹⁷ We agree with Board Member Daniel L. Goelzer that such a list “would afford investors transparency concerning cases in which they may be relying on audit reports of firms that have not been inspected according to the Board’s normal schedule.”¹⁸

Registered Firms’ Obligations

We support the Board’s continuing efforts, described in the Release, “to develop cooperative relationships with its foreign counterparts” to enhance its ability to make timely and rigorous inspections of non-U.S. registered firms.¹⁹ We also understand that “non-U.S. legal restrictions or the sovereignty concerns” may hinder the ability of the Board to conduct those inspections.²⁰ We, however, do not support any easing of Board sanctions on those non-U.S. firms that may be subject to such legal restrictions or sovereignty concerns.

Member Steven B. Harris, Amendments Concerning the Timing of Certain Inspections of Non-U.S. Firms and Other Issues Related to Inspections of Non-U.S. Firms 1 (Dec. 4, 2008),

http://www.pcaobus.org/News_and_Events/Events/2008/Speech/12-04_Harris.aspx.

¹² See *Goelzer*, *supra* note 11, at 1.

¹³ *Id.*

¹⁴ *Niemeier*, *supra* note 9, at 1.

¹⁵ *Id.* This condition appears particularly important in light of allegations that have arisen in the Satyam Computer Services Ltd. accounting scandal that the application and enforcement of auditing standards in India and many other countries “are not always what we’d expect them to be in North American or Western Europe.” Shamra, *supra* note 8, at 1.

¹⁶ *Niemeier*, *supra* note 9, at 1.

¹⁷ *Release*, *supra* note 1, at 14.

¹⁸ *Goelzer*, *supra* note 11, at 1.

¹⁹ *Release*, *supra* note 1, at 15.

²⁰ *Id.* at 16.

In our view, the Release fails to make a compelling case that investors would benefit from the imposition of weaker sanctions on those non-U.S. registered firms that decline PCAOB inspections based on non-U.S. legal restrictions or sovereignty concerns. Moreover, imposing weaker sanctions on those firms might have the perverse effect of lessening the incentive of those firms and other interested parties to actively advocate for the elimination of those restrictions or concerns.

Finally, we do not oppose the Board's consideration of a proposed rule, as described in the Release, that would require a principal auditor that "has failed to provide information in response to an inspection demand on the basis of non-U.S. legal restrictions or sovereignty concerns, [or who has used the work of any registered firm that has failed to provide such information] . . . to disclose that fact [and other related information] as part of, or in connection with, its audit report."²¹ The extensive disclosures set forth in the Release would likely provide investors with useful information in evaluating the quality of the contents of the financial reports audited by those firms. If, however, such a proposed rule is pursued by the Board, it should not, in our view, serve as a replacement for the sanction of deregistering a firm when, after reasonable efforts by the PCAOB, the firm cannot or will not cooperate with the PCAOB's inspections.

Once again, we appreciate the opportunity to comment on the Release. Please feel free to contact me with any questions or comments at jeff@cii.org or at 202.261.7081.

Sincerely,

A handwritten signature in cursive script that reads "Jeff Mahoney".

Jeff Mahoney
General Counsel

²¹ *Id.*