United States Senate

COMMITTEE ON
HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS

WASHINGTON, DC 20510–6250

January 3, 2012

Via Electronic Submission (comments@pcaobus.org)

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

RE: PCAOB Rulemaking Docket No. 29 on Disclosing Audit Engagement Partners

Dear Members of the Board:

The purpose of this letter is to express support for amendments proposed by the Public Company Accounting Oversight Board (PCAOB) to improve audit quality, transparency, and accountability by requiring registered public accounting firms to disclose the name of the lead engagement partner in each audit report and in the firm's Annual Report Form as well as the name of any other independent public accounting firm or other person who took part in the audit.

Strengthening Public Company Audits. The U.S. Senate Permanent Subcommittee on Investigations, which I chair, has long had an interest in strengthening audits of publicly traded corporations to protect investors, prevent fraud, and provide a strong foundation for the American economy. Its investigations have included exposing the poor quality audits that contributed to the collapse of the Enron Corporation,[1] the development and sale of financial products designed to help corporations hide debt on their financial statements,[2] and the development and sale of abusive tax shelter and other schemes by accounting firms and other professionals to minimize corporate taxes and inflate corporate earnings.[3] The Subcommittee's work has contributed to legislative efforts to strengthen the auditing process, including the Sarbanes-Oxley reforms that created the PCAOB, imposed new requirements to ensure auditor independence, and strengthened corporate board oversight of auditing procedures.[4]

Poor quality audits of publicly traded corporations continue to plague the U.S. investment community, allowing misleading accounting, outright frauds, and substantial losses to occur. Egregious recent examples include Olympus Corp., where Japanese affiliates of KPMG and Ernst & Young approved financial statements in which the corporation shifted billions of dollars

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[1] See "The Role of the Board in Enron's Collapse," S. Hrg. 107-511, May 7, 2002.
[2] See "The Role of Financial Institutions in Enron's Collapse," S. Hrg. 107-618, July 23 and 30, 2002.
[3] See, e.g., "U.S. Tax Shelter Industry: The Role of Accountants, Lawyers, and Financial Professionals," S. Hrg. 108-473, November 18 and 20, 2003; "Tax Haven Abuses: The Enablers, The Tools and Secrecy," S. Hrg. 109-797, August 1, 2006, case histories involving the POINT strategy and Kurt Greaves.
[4] See Sarbanes-Oxley Act of 2002, P.L. 107-204.

in investment losses off its balance sheet while including other assets at inflated values;[5] Satyam Computer Services Ltd., where an Indian affiliate of PricewaterhouseCoopers approved financial statements in which the company reported years of inflated assets and cash balances;[6] and Parmalat, where Italian affiliates of Grant Thorton and Deloitte Touche approved financial statements in which the company reported over $5 billion in phantom assets and falsified earnings.[7] Those are on top of older accounting scandals involving prominent public corporations like Enron, WorldCom, Xerox, and Adelphia.[8] These prominent audit failures indicate that more needs to be done to encourage accurate and effective audits of public corporations and increase accountability for poor auditing practices.

Proposed Amendments. In 2009, in a bid to strengthen audit quality, transparency, and accountability, the PCAOB issued a Concept Release seeking comment on whether auditors should require the engagement partner with final responsibility for a particular audit to sign the audit report. The engagement partner is the key person within a registered public accounting firm who is "responsible for the engagement and its performance," and who coordinates and oversees the audit work and issuance of the audit report.[9] After receiving multiple comments, in 2011, the PCAOB issued the revised proposal currently under consideration. This proposal would require public auditors to disclose the name of the engagement partner in each audit report, but would not require the partner to sign the report; it would require each audit report listed in a public accounting firm's Annual Report Form to identify the relevant engagement partner; and it would require each audit report to disclose the name of any independent public accounting firm or other person who took part in the audit. All three of these proposals are important reforms that would strengthen public company audits.

Increased Public Disclosure. The Board's proposal to increase public disclosures about who actually conducts and is responsible for a particular audit is a welcome departure from a history of excessive secrecy and weak accountability for public company audits.

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[5] See, e.g., Graham v. Olympus Corp., Case No. 5:11-cv-07103 (E.D.Pa. filed Nov. 14, 2011), class action complaint, http://www.izardnobel.com/admin/uploads/12368843364ec431add96d8.pdf; "Olympus' Auditors Should Be Scrutinized," Nikkei Report (Nov. 21, 2011), http://global.factiva.com/redir/default.aspx?p=sta&ep=AE&an=NKRP000020111121e7bl0003i&fid=301000010&cat=a&aid=9CAP002100&ns=18&fn=EAFM%20Accounting&ft=g&OD=V2AUbjNaqd6b6yKMegonfnoY9oOdATkhWR19knPBTvmljPNVjs%2fEl5nw%3d%3d%7c2.

[6] See, e.g., SEC v. Satyam Computer Services Ltd., Case No. 1:11-cv-00672 (D.D.C. assigned Apr. 5, 2011), SEC complaint, http://www.sec.gov/litigation/complaints/2011/comp21915.pdf; "Satyam: Not The Only Case PwC Worried About," Accounting Watchdog (Aug. 5, 2011), http://www.forbes.com/sites/francinemckenna/2011/08/05/satyam-not-the-only-case-pwc-worried-about/.

[7] See, e.g., SEC v. Parmalat Finanziaria S.p.A., Case No. 03-cv-10266, (S.D.N.Y. 2004), first amended SEC complaint, http://www.sec.gov/litigation/complaints/comp18803.pdf; In re Parmalat Securities Litigation, No. 1:04-md-01653 (S.D.N.Y. filed Jan. 27, 2009), memorandum opinion, http://online.wsj.com/public/resources/documents/parm.pdf.

[8] See, e.g., Sen. Levin Remarks, Cong. Rec. S6563 (July 10, 2002).

[9] See paragraph 3 of Auditing Standard No. 9, "Audit Planning"; and paragraph 3 of Auditing Standard No. 10, "Supervision of the Audit Engagement."

Most public company audits are now performed by a small number of large firms. The "Big Four" accounting firms, which reported $45 billion in revenue in 2011 alone,[10] employ thousands of auditors with differing experience, qualifications, expertise, and work performance. Currently, these firms provide no routine public information about the engagement partner who is responsible for the audit of a particular company nor do they provide information about any third party contributor to their audits. Investors, lenders, regulators, and others currently have no means for tracking audit partners responsible for accurate audits, audit failures, or audits later found to have varying strengths and weaknesses.

Because auditing firms are paid by the companies whose financial statements they audit, inherent conflicts of interest make public accountability and transparency all the more important. An accounting firm that receives large auditing fees from a client becomes susceptible to pressures by that client to overlook problems or resolve auditing issues in ways that are overly favorable to the client, or risk losing fee revenue. Engagement partners that recommend advising a client to accept a disagreeable auditing result may receive little or no support from colleagues concerned about losing business. Public accountability, in which specific individuals are recognized for high quality audits, as well as audit failures, can be a powerful antidote to such internal pressures.

Disclosing the Engagement Partner. Multiple reasons support disclosing the name of the engagement partner responsible for a particular audit. First is the impact on audit quality. Publicly tying the lead auditor's professional reputation to the audits for which that partner is responsible would encourage the partner to require better audit procedures, exercise better supervision of the audit team, and perform a more careful review of the audit results. It may also deter poor oversight, sloppy procedures, and high risk audit practices leading to unreliable audit opinions. Audit quality would improve, not only because engagement partners would want to protect their professional reputations, but also because public disclosure would expand the audience to which each partner would be routinely answerable, from the partner's firm and the audit client, to the broader business community, including investors, lenders, regulators, policymakers, and fellow auditing professionals.

Second, disclosure of the engagement partner's name would strengthen audit transparency by shedding light on the audit process and facilitating communications. Identifying the engagement partner would alert the audited corporation's officers, directors, audit committee, and employees to the key person responsible for resolving audit issues and help corporate employees communicate any auditing concerns to the right person. It would also inform third parties, including investors, lenders, regulators, and others, of the right person to contact with

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[10] See "PwC reports FY2011 global revenues of US $29.2 billion" (Oct. 3, 2011), http://www.pwc.com/gx/en/press-room/2011/fy2011-global-revenues.jhtml; "Deloitte continues as an engine of employment creation and announces record revenues of US $28.8 billion" (last updated Nov. 7, 2011), http://www.deloitte.com/view/en_GX/global/press/global-press-releases-en/96616a3cfdc82310VgnVCM1000001a56f00aRCRD.htm; Transparency Report 2011 Ernst & Young Global (2011), http://www.ey.com/Publication/vwLUAssets/Global_Transparency_Report_2011/$FILE/Global-Transparency-report-2011.pdf (Ernst & Young worldwide revenue for Statutory Audit and Other Assurance practice, $14 billion); KPMG Annual Review (2010) http://www.kpmg.com/Global/en/WhoWeAre/Performance/AnnualReviews/Documents/KPMG-International-Annual-Review-2010.pdf (KPMG 2010 global revenues by function: Audit practice $ 9.91 billion).

financial reporting interests or concerns. In addition, knowing the key person responsible for an audit could facilitate investigations, simplify research, and aid in evaluations of audit reports. Investigations examining financial misconduct would also be more efficient and effective if they had ready access to the names of the engagement partners responsible for particular audit reports.

Public disclosure would also facilitate evaluation of senior auditors and the audit reports for which they are responsible. Disclosure would enable not only the audit client, but also investors, lenders, regulators, and other financial statement users, to identify and evaluate an engagement partner's experience, expertise, track record, and work for other clients that might present conflict of interest problems.

Third, disclosure of the engagement partner would strengthen both partner and firm accountability for audit failures. Right now, when a company is found to have engaged in misleading or fraudulent accounting, the identity of the engagement partner is not readily apparent; making that information publicly available would facilitate holding particular engagement partners accountable for the audits they oversee. Because both the engagement partner and the public accounting firm would be identified in the audit report, the current proposal intentionally and clearly signals that accountability is intended to attach to both. In addition, as engagement partners are often indemnified by their employers in the same manner as officers and directors of corporations, any lawsuit over inaccurate financial reporting would likely affect the firm as well as the partner, providing an added incentive for the firm to monitor the performance of its engagement partners.

A fourth reason to support the PCAOB proposal is that it would promote auditor independence by highlighting the occasions on which an engagement partner is replaced. The Permanent Subcommittee on Investigations conducted an examination into the collapse of Enron Corporation in 2002, and discovered that when an Arthur Anderson senior partner raised objections to certain Enron accounting practices, he was removed at Enron's request, with no public notice.[11] The Enron investigation demonstrates that even senior auditors can be removed at the request of a client displeased with their accounting advice. Disclosure of an engagement partner's name and any replacement might discourage audit clients from inappropriately pressuring that partner or the audit firm to cooperate with its accounting requests, since any replacement would require public notice and, in turn, raise public questions about the reasons for the replacement. To further support auditor independence, the proposal could be strengthened by requiring registered public accounting firms to file a special report on Form 3 within a few days of replacing an engagement partner in charge of a public company audit.

Still another reason to support disclosure of the engagement partner is that it would bring U.S. audit professionals in line with other U.S. corporate professionals and their international counterparts. U.S. corporate officers already sign their names to a variety of opinions and reports filed with the SEC, including certifications regarding the accuracy of the corporation's financial statements, while a majority of corporate directors sign their corporation's Annual Form 10-K. Attorneys are required to sign a variety of documents filed with federal and state regulators and the courts. In addition, the Federal Reserve already requires bank holding

[11] See, e.g., "The Role of the Board in Enron's Collapse," S. Hrg. 107-511, May 7, 2002, at 5, 582-88.

companies to provide the names of audit engagement partners.[12] The European Union already requires its member states to compel audit reports to be "signed by at least the statutory auditor(s) carrying out the statutory audit on behalf of the audit firm."[13] The PCOAB would bring U.S. audit professionals into closer alignment with other public company professionals by requiring public auditors to identify their audit engagement partners in the documents which they make publicly available and which they intend to be relied upon by the investing public.

Requiring A Signature. The PCAOB proposal seeks comment on whether, in addition to disclosing the name, an engagement partner should be required to sign the audit report for which the partner is responsible. The proposal should require such signatures. Critics contend that requiring a signature would increase liability for individual audit partners, while decreasing the liability of the audit firm as a whole. Those criticisms fail to acknowledge, however, that through indemnification and insurance agreements, the liability of senior audit partners and their employers are already typically closely intertwined. In addition, professions such as public accounting have long nurtured trust and respect by placing the reputation of their senior professionals on the line in support of their work. An audit report that carries the personal signature of a financial professional would not only strengthen audit quality, transparency, and accountability, but also help restore the personal responsibility critical to a trustworthy and respected accounting profession.

Disclosing Engagement Partners in Annual Reports. Public accounting firms currently file with the PCAOB an Annual Report Form listing each of the audit reports they have issued during the covered year.[14] The proposal would amend the Annual Report Form to also require public accounting firms to identify the engagement partner for each of their listed audits. This proposed disclosure offers an inexpensive, sensible, and effective means for further strengthening public audits.

The proposed disclosure would provide a convenient mechanism for financial statement users to retrieve information about the work assigned by a public accounting firm to its engagement partners over the course of a year. The information would appear in one location and would be easily accessible since the annual reports are posted by the PCAOB on its website. The proposal would facilitate auditor oversight by making it easy for audit clients, investors, lenders, regulators, and others to research the work of a particular engagement partner, including by identifying the other clients the partner serves, evaluating the partner's workload, and making it easier to identify any conflict of interest or disciplinary issues. It would also facilitate oversight of audit firms as a whole by making all of the work assignments made to individual engagement partners available in one location.

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[12] See Form FR Y-9C, "Consolidated Financial Statements for Bank Holding Companies," at 11.

[13] "Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on Statutory Audits of Annual Accounts and Consolidated Accounts," L157 OFFICIAL JOURNAL OF THE EUROPEAN UNION 87, 96, 98 (Sept. 6, 2006), http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:157:0087:0087:EN:PDF .

[14] See PCAOB Rule 2201; PCAOB Form 2 - Annual Report Form, http://pcaobus.org/Rules/PCAOBRules/Pages/Form_2.aspx; "Staff Questions and Answers Annual Reporting on Form 2," PCAOB, at 1, 2 (June 17, 2011), http://pcaobus.org/Registration/rasr/Documents/Staff_QA-Annual_Reporting.pdf (stating "[e]ach registered firm must provide basic information once a year by filing an annual report on Form 2."). The report must be filed by June 30 of each year.

Naming engagement partners in the Annual Report Form would further strengthen audit quality, transparency, and accountability by enabling more efficient and effective research into the work of individual partners and of audit firms as a whole. These disclosures would encourage engagement partners to provide consistent, high quality work, because knowing that the public can obtain one's name only by inquiring about a particular audit is not the same as knowing that the public can easily associate one's name with every audit performed during the year. In addition, the disclosures would help ensure that public accounting firms assign audits to engagement partners with appropriate expertise and availability, and avoid conflicts of interest that might otherwise be hidden from public view. The disclosures could also promote auditor independence by highlighting any engagement partner replacements during the covered year.

Disclosing Third Party Audit Participants. In addition to disclosing engagement partner names, the PCAOB proposal contains an important provision that would require disclosure of third party participants in particular audits. This provision would shine needed sunlight on a little known and difficult to monitor area of auditing, while significantly strengthening audit quality, transparency, and accountability.

When investors see the name of a major auditing firm on an audit report, they may make certain assumptions about the quality of that audit based upon that company's reputation. It is often the case, however, that an accounting firm issuing an audit report has not performed 100% of the underlying audit work, but has instead delegated all or a portion of the work to one or more outside parties, including independent auditing firms or specialists in particular areas. In addition, the accounting firm may have supervised and taken responsibility for the work performed by the third party, or may have contracted to hold the outside party solely responsible for the work it performed. Audit clients, investors, lenders, regulators, and others may be unaware of the extent to which some or all of the work in a particular audit was outsourced to outside parties. They may also be unaware of the identity of the third parties that actually performed the audit work and the extent to which the firm issuing the audit report has relied upon and taken responsibility for that work. Since auditors vary significantly in their expertise, resources, and reputation, knowing which parts of an audit were outsourced and who performed what portions of the work may be critical to assessing audit quality.

The Permanent Subcommittee on Investigations has firsthand experience with the variability of audit work performed by different firms. For example, a year-long investigation conducted by the Subcommittee into illicit money flows involving banks in foreign jurisdictions uncovered a host of problems with foreign auditors, especially those operating in foreign jurisdictions with strong secrecy laws and weak anti-money laundering controls.[15] A number of foreign accountants contacted during the investigation were uncooperative or even hostile when asked for information. A PricewaterhouseCoopers auditor in Antigua serving as a government-appointed liquidator for Caribbean American Bank (CAB), for example, refused to provide copies of its report on CAB's liquidation proceedings, even though the reports were filed in court, they were supposed to be publicly available, and the Antiguan government had asked the auditor to provide the information to the investigation. The investigation also came across evidence of conflicts of interest and incompetent or dishonest accounting practices. In one

[15] See "Role of U.S. Correspondent Banking in International Money Laundering," S. Hrg. 107-84, March 1, 2001. This investigation took place prior to the establishment of the PCAOB.

instance, an accounting firm verified a $300 million item in a balance sheet for British Trade and Commerce Bank that, when challenged by Dominican government officials, was never substantiated. In another instance, an accounting firm approved an offshore bank's financial statements which concealed indications of insolvency, insider dealing, and questionable transactions. While the above examples involved foreign auditors reviewing the records of local banks and not U.S. publicly traded corporations, this record of poor performance and poor cooperation with U.S. inquiries does not inspire confidence.

The recent auditing failures cited earlier also do not inspire confidence. Accounting scandals involving Olympus Corp., Satyam Computer Services Ltd, and Parmalat, for example, involve foreign auditors that share a common brand with one of the Big Four accounting firms, but may not use the same auditing standards, have the same familiarity with U.S. accounting requirements, or employ auditors with appropriate expertise. It is also not uncommon for a Big Four accounting firm to refuse to accept liability for faulty audit work performed by a foreign affiliate, even when sharing a common brand. Audit clients, investors, lenders, regulators, and others ought to be able to determine the extent to which affiliated or unaffiliated third parties are performing audit work, the extent to which the public accounting firm supervised that work, and the extent to which the public accounting firm shares liability for any problems arising from the audit work performed by a third party.

Another key issue is the extent to which a third party performing audit work falls under PCAOB jurisdiction, cooperates with PCAOB and SEC information requests, and undergoes PCAOB inspections to ensure audit quality. Auditors outside the United States may not have agreed to undergo PCAOB oversight, even if they audit a company that trades on a U.S. stock exchange or holds a U.S. license as a broker-dealer. Alternatively, the firm may have agreed to PCAOB oversight, but their governments may not permit PCAOB inspections or exchanges of information. In a recent investigation into alleged accounting fraud affecting U.S. investors of Longtop Financial Technologies, for example, China has apparently ordered the Shanghai affiliate of Deloitte & Touche not to provide documents to the PCAOB or SEC or to undergo PCAOB inspections.[16] A 2007 PCAOB report also criticizes Deloitte's quality controls and the manner in which it works with foreign affiliates operating under a common brand, noting that Deloitte partners often had no way to properly assess whether a foreign affiliate's personnel were adequately familiar with American accounting and auditing rules.[17] Audit clients, investors, lenders, regulators, and others should be able easily to determine whether audit work is being performed by auditors that operate outside of PCAOB oversight, have poor track records, or have a history of disciplinary problems or other misconduct.

The PCAOB proposal is to be commended for requiring the disclosure of the names of third party participants in an audit. The proposal should be further strengthened by requiring the public accounting firm issuing the audit report to disclose the nature and extent of the work

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[16] See, e.g., SEC v. Deloitte Touche Tohmatsu CPA Ltd., Case No. 1:11-MC-00512 (D.D.C. filed September 8, 2011); In re Longtop Financial Technologies Ltd., Case No. 3-14622 (Nov. 10, 2011), http://www.sec.gov/litigation/admin/2011/34-65734.pdf; "Deloitte's Quandary: Defy the S.E.C. or China," New York Times (Oct. 20, 2011), http://dealbook.nytimes.com/2011/10/20/deloittes-quandary-defy-the-s-e-c-or-china/.

[17] "Report on 2007 Inspection of Deloitte & Touche LLP," PCAOB Release No.104-2008-070A, at 1, 3, 17 (May 19, 2008), http://pcaobus.org/Inspections/Reports/Documents/2008_Deloitte.pdf.

performed by each third party; whether it supervised and shares financial responsibility for the audit work performed by each such party; and whether each such third party is subject to PCAOB oversight and has undergone PCAOB inspection.

Thank you for the opportunity to comment on this matter.

Sincerely,

Carl Levin

Carl Levin
Chairman
Permanent Subcommittee on Investigations