EXHIBIT A

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

IN RE PLAINTIFF SECURITIES LITIGATION	No. 1:04-cv-01639 (RJL)
FRANKLIN MANAGED TRUST *et al.*, *Plaintiffs*, v. FEDERAL NATIONAL MORTGAGE ASSOCIATION *et al*., *Defendants.*	No. 1:06-cv-00139 (RJL)

BRIEF AMICUS CURIAE ON BEHALF OF THE CENTER FOR AUDIT QUALITY

The Center for Audit Quality ("CAQ") respectfully submits this brief as *Amicus Curiae* in opposition to the Motion of Fannie Mae (hereinafter the "Plaintiff") to Compel KPMG's Production of Documents Related to the Public Company Accounting Oversight Board.

STATEMENT OF INTEREST

The CAQ is a public policy organization that commenced operations in January 2007. The mission of the CAQ is to seek to foster confidence in the audit process and to aid investors and the capital markets by advancing constructive suggestions for change that are rooted in the profession's core values of integrity, objectivity, honesty, and trust. We also seek to improve the reliability of public company audits and to enhance their relevance for investors in this time of increasing financial complexity and globalization. The CAQ is led by a governing board that comprises leaders from public company auditing firms and the American Institute of Certified Public Accountants ("AICPA"), as well as public board members who bring an outside perspective to the CAQ's agenda and activities.

Since its founding the CAQ has undertaken research, offered recommendations to enhance investor confidence and the vitality of the capital markets, issued technical support for public company auditing professionals, and helped facilitate the public discussion about modernizing business reporting. Any U.S. accounting firm registered with the Public Company Accounting Oversight Board ("PCAOB") may join the CAQ. The CAQ is affiliated with the AICPA, and has approximately 750 U.S. public company auditing firms as members, representing tens of thousands of professionals dedicated to audit quality. The CAQ is led by a governing board that is comprised of leaders from public company audit firms and the AICPA, as well as public board members. The CAQ has a strong interest in the issues raised by Plaintiff's Motion to Compel because of the potentially serious implications that granting the motion could have for the effectiveness of the PCAOB in fostering audit quality and reliability.

INTRODUCTION

In 2002, pursuant to the Sarbanes Oxley Act, Congress created the PCAOB "to provide for more effective oversight of the part of the nation's accounting industry that audits public companies."[1] The inspection and investigation process of the PCAOB is essential to fostering and maintaining audit quality and reliability. In establishing the PCAOB, Congress created a supervisory model of regulation designed to encourage a "constructive dialogue" between the PCAOB and the audit firms it regulates.[2] Congress recognized that the confidentiality of the PCAOB's processes was a critical element in fostering that dialogue. That recognition is embodied in two provisions of the Act. Section 105(b)(5)(A) of the Act explicitly provides that all documents and information prepared or received by the PCAOB in connection with an inspection or investigation shall be confidential and further explicitly protects such material from civil discovery. Section 104(g) of the Act relates specifically to inspection reports and requires the PCAOB to keep confidential that portion of its reports that deals with criticisms of or potential defects in the quality control systems of the firm under inspection, provided that the audit firm addresses such criticisms or defects to the Board's satisfaction.

In the motion presently before the Court, Plaintiff urges a construction of Sections 105(b)(5)(A) and 104(g) that, by negating the protections from civil discovery created by those provisions, will undermine the open and constructive regulatory regime designed by Congress and implemented by the PCAOB. The CAQ urges this Court to protect the quality and reliability of the audit process and reject that construction of the statute.

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[1] S.Rep.No.107-205 at 4 (July 3, 2002).

[2] PCAOB Release 104-2006-077 (March 21, 2006) at 2.

STATEMENT

In the wake of the collapse of Enron and other major Fortune 500 companies, Congress sought to address serious questions that had been raised regarding "the integrity of certified financial audits; appropriate accounting principles and auditing standards; the effectiveness of the accounting regulatory oversight system; [and] the impact of auditor independence on the quality of audits . . . ."[3] In response, Congress passed the Sarbanes Oxley Act of 2002, which comprehensively addressed these issues. In order to improve the quality of financial reporting, the Act addressed, among other things, auditor independence, corporate responsibility, enhanced corporate disclosure, and provided greater resources to the SEC and other agencies.

Congress was particularly concerned about the failure of the then current system of regulation of audit firms that audited public companies, a system that was subject to "a bewildering array of monitoring groups."[4] The Public Oversight Board ("POB"), one of the several entities that regulated accountants and auditors, was subject to particular criticism for being "slow and ineffective."[5] The POB itself recognized its deficiencies and agreed with the criticism of a former SEC Commissioner that its system "results in long delays in investigation and, as a practical matter, renders the disciplinary function a nullity in almost all instances."[6]

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[3] *See Accounting Reform and Investor Protection: Hearing on S. 2763 Before the S. Comm. on Banking, Housing, and Urban Affairs,* 107th Cong. 723 (2002) (Opening Statement of Senator Sarbanes).

[4] S. Rep. No. 107-205 at 4 (July 3, 2002)

[5] *Id.* at 5

[6] "The Road to Reform, " A White Paper from the Public Oversight Board on Legislation to Create a New Private Sector Regulatory Structure for the Accounting Profession (March 19, 2002)

According to the POB, its inability to protect information from litigants was a significant reason for its ineffectiveness:

> One reason for the delay in the current system stems from the fact that those charged with administering the system lack privilege to ascertain facts. Privilege would give the investigative entity the authority to protect information it uncovers from outside demands until any enforcement action is concluded. At present, firms will not disclose documents or other information that is likely to wind up in the hands of litigants in legal proceedings.[7]

The POB's inability to protect information affected not only its disciplinary functions but its ability to provide broader regulatory oversight. When asked by the SEC to review issues relating to auditor independence, the POB's efforts were stymied because it could not enter into satisfactory confidentiality agreements with the audit firms from which it was seeking information.[8]

The necessity for confidentiality was a recurrent theme by witnesses at Congressional hearings investigating the prior system. Shaun F. O'Malley, former Chairman of the Panel on Audit Effectiveness, testified that the oversight of the POB was "hampered by distrust and by concerns that the materials developed were not protected."[9] He went on to state that "[p]roviding confidentiality will expedite and vastly improve the review, investigatory, and disciplinary processes."[10] Joel Seligman, the Dean of the Washingon University School of Law in St. Louis, and a member of the AICPA Professional Ethics Executive Committee testified that he recommended "a privilege from discovery of investigative files to facilitate auditing discipline

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[7] *Id.*

[8] *Id.*

[9] *Accounting Reform and Investor Protection: Hearing on S. 2763 Before the S. Comm. on Banking, Housing, and Urban Affairs*, 107th Cong. 723 (February 2002).

[10] *Id.*

during the pendency of other Government or private litigation."[11] John Biggs, the CEO of TIAA-CREF, a major user of financial statements who also served on the POB testified that:

> the investigative authority of a new accounting regulatory body needs to be clear-cut and not simply a derivative of the SEC. Accounting firms must know that they cannot refuse to open their books or prevent their staff from cooperating with this new agency. *Of course, it must have the ability to keep the information gathered out of the hands of the litigating lawyers.*[12]

In response, Congress created the Public Company Accounting Oversight Board ("PCAOB" or "the Board") in 2002 to "establish, adopt, or modify auditing, quality control, ethics, and independence standards for public company audits, inspect accounting firms, investigate potential violations of applicable rules relating to audits, and impose sanctions if those violations are established."[13]

In designing the structure of the PCAOB's investigative and inspection functions, Congress took care to address the confidentiality concerns that had plagued the POB by enacting Section 105(b)(5)(A) and Section 104(g) of the Sarbanes Oxley Act ("the Act").

Section 105(b)(5)(A) reads as follows:

> CONFIDENTIALITY—Except as provided in subparagraph (B), all documents and information prepared or received by or specifically for the Board, and deliberations of the Board and its employees and agents, in connection with an inspection under section 104 or with an investigation under this section, shall be confidential and privileged as an evidentiary matter (and shall not be subject to civil discovery or other legal process) in any proceeding in any Federal or State court or administrative agency, and shall be exempt from disclosure, in the hands of an agency or establishment of the Federal Government, under the Freedom of Information Act (5 U.S.C. 552a), or otherwise, unless and until presented in connection with a public proceeding or released in accordance with subsection (c).

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[11] *Id.*

[12] *Id.* (emphasis added)

[13] S. Rep. No. 107-205 at 4 (July 3, 2002).

Section 104(g) applies to PCAOB inspection reports. It reads as follows:

> [A written report] shall be made available in appropriate detail to the public (subject to [Section 105(b)(5)(A)], and to the protection of such confidential and proprietary information as the Board may determine to be appropriate, or as may be required by law), except that no portions of the inspection report that deal with criticisms of or potential defects in the quality control systems of the firm under inspection shall be made public if those criticisms or defects are addressed by the firm, to the satisfaction of the Board, not later than 12 months after the date of the inspection report.

The legislative history of these two provisions shows that it was the intent of Congress to keep Board documents and information relating to investigations and inspections confidential and "privileged from outsiders" in order to create a supervisory model of regulation that encourages cooperation and dialogue and discourages adversarial confrontation.[14] Section 105(b)(5)(A) explicitly keeps Board information "out of the hands of litigating lawyers"[15] unless and until, in the case of investigations, the Board brings a public disciplinary proceeding.[16] The provision creates an evidentiary privilege for investigative and inspection materials and it exempts such materials from discovery in civil proceedings. Moreover, Section 105(b)(5)(A) goes even further to preserve confidentiality by providing an explicit exemption from the Freedom of Information Act should the PCAOB decide to share such materials with a federal agency.

Section 104(g) covers inspection reports and though it requires the Board to make certain portions of its inspection reports public, the provision further requires the Board to afford

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[14] S. Rep. No. 107-205 at 10 (July 3, 2002).

[15] *Accounting Reform and Investor Protection: Hearings on S. 2763 Before the S. Comm. on Banking, Housing and Urban Affairs,* 107th Cong. 723 (February 2002)(Testimony of John H. Biggs)

[16] But even in such cases, hearings are public only with the consent of the parties. See Section 105(c)(2) of the Act.

appropriate protection to proprietary and confidential information of audit firms and completely prohibits the public release of "criticisms of or potential defects in the quality control systems" of audit firms if those criticisms and defects are appropriately addressed.

Through the enactment of the confidentiality provisions of the Act, Congress eschewed an adversarial regulatory model that would rely solely on the power to coerce the production of information through a combination of subpoenas and sanctions. Instead, it sought to encourage a cooperative relationship between the Board and the audit firms that it regulates in which firms have an incentive to work hand-in-hand with the Board to identify weaknesses in audit processes. Absent the confidentiality provisions of the Act, audit firms would be more likely to respond narrowly to Board information requests, being ever vigilant to the liability concerns that a broader, more cooperative approach might entail. With the benefit of the confidentiality built into the Act, PCAOB implemented a cooperative, supervisory approach. As the Board has stated:

> Section 104(g)(2) of the Act reflects a legislative policy choice favoring the correction of quality control problems over the exposure of them. Accordingly, the Board takes a supervisory approach to oversight and seeks through constructive dialogue to encourage firms to improve their practices and procedures. Every Board inspection report that includes a quality control criticism alerts the firm to the opportunity to prevent the criticism from becoming public. The inspection report specifically encourages the firm to initiate a dialogue with the Board's Inspections staff about how the firm intends to address the criticisms.[17]

The supervisory model of regulation created by Sarbanes Oxley and implemented by PCAOB has thus far worked well and has resulted in substantial improvements to the quality and reliability of audits of public companies. It has worked to the satisfaction of both Board and the regulated community. In March 2006, the Board published a release containing its initial

[17] PCAOB Release 104-2006-077

observations with respect to success of the supervisory model:

> The Board's initial experience with the 12-month remediation process generally validates the premise of the approach set out by Congress in Section 104(g)(2) of the Act. That legislative approach rested on the hypothesis that firms could be genuinely motivated by the prospect of keeping the Board's quality control criticisms confidential. The Board's initial experience with the larger firms supports that hypothesis. Moreover, the firms were responsive to the Board's supervisory model, taking the initiative to engage constructively with the staff in an ongoing dialogue toward a result satisfactory to the Board, rather than emphasizing points of disagreement and taking an adversarial approach.
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> As a result of the process, the Board believes that those firms have crafted and undertaken important steps that, if conscientiously implemented, will have beneficial effects on audit quality. [18]

In the PCAOB's 2007 Annual Report, its Chairman, Mark W. Olson stated:

> Our primary goal is to promote investor confidence in audited financial statements of public companies through effective use of a supervisory model of oversight of registered public accounting firms. Other goals speak to ensuring robust two-way communication with the audit profession, market participants and other interested parties, and to further strengthen the effectiveness and coordination of auditor oversight efforts in the United States and abroad.[19]
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> We increasingly are finding that the PCAOB can foster improvement in audit quality through the on-site dialogue the inspection process allows for, in addition to more formal findings in inspection reports and other oversight actions. The PCAOB employs several channels of communication with registered firms, which range from outreach and informal briefings on relevant issues, to inspections and issuance of inspection reports, to investigations and formal disciplinary actions.[20]

In the present litigation, Plaintiff has urged a much narrower view of the confidentiality provisions of Sarbanes Oxley, one that we believe will lead to the destruction of the supervisory model that the Act envisions. Moreover, Plaintiff's position would damage more than the Board's efforts to facilitate "constructive engagement" with audit firms. It would harm the flow

[18] Id.

[19] 2007 PCAOB Annual Report at p. 2

[20] *Id.* at 3

of information between issuer and auditor. Board inspections and investigations require the auditor to produce confidential information about its audit clients so that the Board can review the auditor's work. *See, e.g.*, PCAOB Rule 4006 (requiring registered public accounting firms to cooperate by providing "any record" in its possession that the Board requests pursuant to an inspection). If this confidential information must be revealed when the auditor is sued for its work on other unrelated engagements—as Plaintiff would have it—clients will swiftly, and understandably, become reluctant to share confidential information with their auditors. Indeed, this is an important reason why public versions of Board inspection reports redact client identity. PCAOB Rule 4010 ("[N]o such published report shall identify the [clients] to which such criticisms relate."). Preserving the confidentiality of this information is therefore essential to ensuring that the PCAOB's inspections do not chill the auditor-client relationship and hamper auditors' efforts to effectively monitor their clients.

ARGUMENT

In Enacting Sarbanes Oxley, Congress Intended to Protect from Civil Discovery Documents of the Kind Sought by Plaintiff

Through its motion, Plaintiff seeks from KPMG the production of PCAOB investigative transcripts, various PCAOB inspection reports and documents relating to such inspection reports and investigation. These are precisely the kind of documents that Congress determined should be protected from civil discovery when it designed the PCAOB regulatory process to avoid the pitfalls associated with its predecessor, the POB.

The language of Section 105(b)(5)(A) is clear on its face. It states that "all documents and information prepared or received by or specifically for the Board . . . in connection with an inspection . . . or with an investigation . . .shall be confidential and privileged as an evidentiary matter (and shall not be subject to civil discovery or other legal process) in any proceeding in

any Federal or State court or administrative agency." There are only two exceptions to the strict confidentiality imposed by the Act. The PCAOB may share such information with other governmental agencies, as long as those agencies agree to keep the information confidential. In addition, the PCAOB may make such information public in connection with public disciplinary hearings and the imposition of sanctions. But even the exceptions are circumscribed with further safeguards. The Act specifically creates a FOIA exception for any federal agency that receives such information from the PCAOB, and as to disciplinary hearings, Section 105(c)(2) of the Act provides that the hearings may be public only with the consent of the parties.

Final inspection reports, which Plaintiff also seeks, are specifically protected by Section 104(g). The PCAOB must make those public, "except that no portions of the inspection report that deal with criticisms of or potential defects in the quality control systems of the firm under inspection shall be made public if those criticisms or defects are addressed by the firm, to the satisfaction of the Board, not later than 12 months after the date of the inspection report."

Plaintiff's response to the clear language is to assert that the language does not mean what it says, that what the language means but does not say is that the strict confidentiality afforded the documents and information only applies so long as the documents are in the hands of the PCAOB. Once out of the PCAOB's hands, unless otherwise protected, as in Section 105(b)(5)(B), their confidential status disappears.

Plaintiff's interpretation would eviscerate the cooperative regulatory model created by the Act. In the context of PCAOB inspections, for example, it is common for there to be a significant amount of discussion between the PCAOB staff and the audit firm subject to inspection. Typically, an inspection will commence with PCAOB staff

reviewing materials and engaging in a substantive dialogue with respect to issues the staff has identified. As a result of such discussions, matters that may have concerned the PCAOB staff can be clarified and may cease to be issues, thus making the rest of the inspection process more efficient and more effective. Thereafter, the PCAOB staff will prepare specific written comments which are then followed by written responses from the audit firm. Subsequently, the PCAOB will provide a draft of its inspection report with the audit firm. The firm then has an opportunity to address the draft findings in writing with a view to satisfying any issues or concerns. After considering the responses of the audit firm, the PCAOB will make public portions of the report that do not deal with the firm's quality control systems. Under this regulatory structure audit firms understand that they can interact with their regulator confidentially and make appropriate enhancements to audit methodology, procedures and internal practices without subjecting all the documents and information created during the process to discovery. That process is exactly the process contemplated by the Act. Without the assurance of confidentiality, firms will be more likely to take a defensive posture with the PCAOB and less likely to acknowledge PCAOB comments and criticisms. Such a result would be contrary to the very purpose of the Act.

Building on the overall confidentiality for the inspection process provided by Section 105(B)(5)(A) is the requirement of Section 104(g) that portions of the final inspection reports involving criticisms of or potential defects in an audit firm's quality control systems be kept confidential if the firm addresses the issues within 12 months to the satisfaction of the Board. Of necessity, the process of obtaining the Board's satisfaction involves written communications internally at the firm and in

communications with PCAOB staff to analyze, discuss and address any perceived control system deficiencies. The statute requires that this process take place confidentially.

Plaintiff apparently takes the position that all the information discussed above and all the documents which underlie the inspection process and the resolution of inspection issues are fair game for litigants so long as is the information and documents are in the hands of the audit firm. Moreover, under Plaintiff's interpretation of the Act, documents and other information employed by audit firms to obtain the requisite finding from the Board that information should be kept confidential in the final report would vitiate that confidentiality because such information resides in the hands of the audit firm. Plaintiff's interpretation makes the promise of confidentiality built into the Act a mere illusion.

With respect to investigative transcripts, Plaintiff's interpretation would rob such material of its privileged nature even if the investigation were still ongoing. Under its Rule 5102(d), PCAOB is required to give a witness at least 15 days to review his transcript for accuracy. Pursuant to Plaintiff's position that confidentiality applies only when the document is in the hands of the PCAOB, that transcript would be free game for discovery, no matter what Section 105(b)(5)(A) states and no matter the disruption to the PCAOB's otherwise confidential investigation.

At bottom, Plaintiff appears to be frustrated because it believes that PCAOB investigative materials should be subject to discovery in the same way, and under the same rules, as investigative materials gathered by the SEC or OFHEO are subject to discovery. As would any litigant, Plaintiff, as stated in its motion, would like to obtain the "benefit of the transcripts to cross-examine deponents and determine if testimony in the litigation is consistent with testimony provided to the regulators." But the fact of the matter is that the statutes under which the SEC

and OFHEO were created do not have an analogue to Section 105(b)(5)(A) of the Sarbanes Oxley Act and the difference in treatment follows ineluctably from the difference in the statutes.

CONCLUSION

Congress created the PCAOB to remedy a previously dysfunctional regulatory structure. As the PCAOB has stated, its goal is to ensure a "robust two-way communication with the audit profession, market participants and other interested parties, and to further strengthen the effectiveness and coordination of auditor oversight efforts in the United States and abroad.[21] That goal is primarily possible because Congress explicitly protected such "two-way communication" through the enactment of the strict confidentiality provisions set forth in the Sarbanes Oxley Act. The CAQ respectfully submits that this Court should honor Congress' intention by denying Plaintiff's motion.

Dated: April 3, 2009

Respectfully submitted,

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[21] 2007 PCAOB Annual Report at p. 2