February 3, 2014

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

Re: PCAOB Rulemaking Docket Matter No. 029: Improving the Transparency of Audits: Proposed Amendments to PCAOB Auditing Standards to Provide Disclosure in the Auditor's Report of Certain Participants in the Audit

Dear Office of the Secretary:

The Center for Audit Quality (CAQ) is an autonomous public policy organization dedicated to enhancing investor confidence and public trust in the global capital markets. The CAQ fosters high quality performance by public company auditors, convenes and collaborates with other stakeholders to advance the discussion of critical issues requiring action and intervention, and advocates policies and standards that promote public company auditors' objectivity, effectiveness, and responsiveness to dynamic market conditions. Based in Washington, D.C., the CAQ is affiliated with the American Institute of Certified Public Accountants.

The CAQ welcomes the opportunity to comment on the Public Company Accounting Oversight Board's (PCAOB or the Board) *Improving the Transparency of Audits: Proposed Amendments to PCAOB Auditing Standards to Provide Disclosure in the Auditor's Report of Certain Participants in the Audit* (the Proposal). This letter represents the observations of the CAQ, but not necessarily the views of any specific firm, individual, or CAQ Governing Board member.

Similar to views previously expressed on this topic,[1] the CAQ supports the PCAOB's efforts to be responsive to calls from financial statement users for further transparency in the audit. However, we do not believe the identification of the engagement partner will provide meaningful information to financial statement users or result in incremental improvements in audit quality, and could result in many practical challenges and liability considerations, particularly if such identification is included in the auditor's report. Should the Board continue to move forward with this aspect of the Proposal, we believe some of these challenges would be mitigated if identification of the engagement partner was reflected within the Form 2 filing, with possible submission of this information on a more timely basis, or in the audit committee report (or elsewhere in the proxy statement), as opposed to including the information in the auditor's report. However, regardless of where this information might be provided, we believe there are unintended consequences associated with identifying the engagement partner, and we

[1] See the CAQ's comment letters to the PCAOB dated September 11, 2009 and January 9, 2012.

encourage the PCAOB to consider these consequences in evaluating whether to move forward with this aspect of the Proposal.

The Proposal also contemplates requiring disclosure within the auditor's report of information about certain other participants, including other independent public accounting firms. The CAQ supports providing additional information to financial statement users to enhance their understanding of the auditor's role and responsibilities, including the disclosure of information about certain other participants in the audit. However, we believe the proposed approach of including this information in the auditor's report carries with it practical challenges and liability considerations, predominately related to obtaining and providing consents. Should the Board require disclosure of information about certain other participants in the audit, we believe it is more appropriate for this information to be provided within Form 2 or in the audit committee report (or elsewhere in the proxy statement), as opposed to including the information in the auditor's report. We believe these alternatives would provide financial statement users with accessible information on certain other participants involved in the audit, while mitigating many of the practical challenges and liability considerations associated with providing this information in the auditor's report.

In this letter, we set forth our views regarding potential practical challenges and liability considerations associated with engagement partner identification and providing information on certain other participants in the audit within the auditor's report and suggest, for the Board's consideration, alternative approaches for disclosure of this information that would mitigate many of these concerns. We also expand upon the unintended consequences of identifying the engagement partner, regardless of the location. We have organized our observations as follows:

- Practical Challenges in Obtaining Consents
- Liability Considerations
- Alternative Approaches to the Auditor's Report
- Unintended Consequences of Identifying the Engagement Partner
- Additional Suggested Enhancements to the Disclosure of Certain Other Participants
- Scope of the Proposal

Practical Challenges in Obtaining Consents

The Proposal states that "the Board has assumed that engagement partners and participating accounting firms named in an auditor's report would have to consent…to the inclusion of their names in…an auditor's report filed with, or included by reference in, another document filed under the Securities Act with the Commission."[2] We appreciate the Board providing its understanding regarding the need for consents to be provided by engagement partners and certain other participants named in the auditor's report. However, we believe there are numerous practical challenges that could occur in providing such consents, and have expanded upon many of these challenges below.

Challenges in Obtaining Engagement Partner Consents

There are instances where obtaining a consent from an engagement partner would be challenging, particularly in situations where audit reports need to be reissued and the engagement partner named in the original auditor's report is no longer associated with the audit firm (e.g., resigned or retired). In these situations, there may be delays in obtaining a consent from the original signing engagement partner. This could lead to delays in the issuer's ability to timely file a registration statement, and affect the completion of capital market transactions. Further, there may be instances where a consent cannot be obtained. For example, a former

[2] Pages 21-22, the Proposal.

engagement partner, no longer associated with the audit firm that issued the auditor's report, may be unable or unwilling to issue a consent. In these instances, the inability to obtain a consent could have implications to the issuer filing a registration statement, and it is unclear what recourse, if any, the issuer would have to ensure the registration statement is filed timely and considered complete.

Additionally, a former engagement partner who is no longer associated with the audit firm that issued the auditor's report may be more cautious (given the associated personal liability) when deciding whether to provide a consent, related to a subsequent registration statement, for an issuer for which he or she is no longer involved. If he or she does agree to provide a consent, he or she would likely want to perform certain update procedures.[3] However, it is unclear whether such individuals would be allowed to perform certain procedures, due to concerns over the sharing of confidential information. For example, a former engagement partner might become a financial officer of a company that is a competitor of an issuer seeking his or her consent for inclusion in a registration statement. Similarly, an engagement partner may have changed audit firms and a consent is required for an issuer the partner served as the lead engagement partner while at the previous audit firm, and there may be concerns with sharing information between firms. Under these scenarios, the former engagement partner may not be allowed access to the draft registration statement or other related documents, and if precluded from performing the update procedures that he or she believes are necessary, may not be willing to provide a consent.

There could also be implications on a partner's ability to perform procedures on an engagement in which a consent is requested, when the partner is in a rotation 'time-out' period. For instance, in situations where a partner has rotated off an engagement after the five-year service period, and a registration statement is filed prior to issuance of the subsequent year's auditor's report, a consent would be required from the former engagement partner. As the former engagement partner is subject to liability under Section 11 of the Securities Act of 1933 (Section 11), he or she would likely perform or direct the performance of certain procedures, including reviewing the draft registration statement and other update procedures, in order to demonstrate that he or she has a reasonable basis to sign the consent. However, it is unclear whether the Securities and Exchange Commission's (SEC) independence rules would limit the former engagement partner's performance of such procedures during his or her rotation 'time-out' period. In cases where the audit firm issues a consent, these procedures could be performed by the engagement team under the leadership of the new or incoming engagement partner. However, if the former engagement partner is identified in the audit report, he or she will also need to issue a consent. We do not believe it would be appropriate to expect the former engagement partner to provide a consent in connection with a filing when he or she had no opportunity to perform (or direct the performance of) procedures that he or she might consider necessary, under the circumstances.

Challenges in Obtaining Consents from Certain Independent Public Accounting Firms

Similar to the challenges discussed above with respect to obtaining consents from the engagement partner, there could be circumstances that prevent or hinder the ability to obtain timely consents from certain other independent public accounting firms that participated in the audit. For instance, other audit firms identified within the auditor's report (i.e., a participating audit firm), regardless of the level of its involvement in the audit, will most likely want to review the filing and perform additional (or update) procedures before providing a consent.[4] This could delay the process of filing a registration statement, particularly if there are a number of audit firms involved in the audit that are required to provide consents.

[3] PCAOB auditing standards do not address what procedures are necessary, in instances where an engagement partner is providing a consent for an issuer for which he or she is no longer involved.

[4] PCAOB auditing standards do not address what procedures are necessary, in instances where a consent is required from a participating audit firm, notwithstanding the fact that it only performed limited audit procedures at the direction of the principal auditor (i.e., has not completed a standalone audit or issued an auditor's report).

A participating audit firm's responsibility is often limited to a specific subsidiary or area of focus. However, if a consent is required from the participating audit firm, and given the associated increase in Section 11 liability, it is likely that it would perform additional procedures, and may also seek a broader understanding of the registration statement and any related issues, including inquiring about perceived concerns in areas in which it did not have direct responsibility.

Consents obtained from participating audit firms would also need to be dated concurrently with the filing, which could lead to logistical challenges in coordinating with multiple parties to complete the necessary procedures and provide the consents at the same time. Further, certain other independent public accounting firms, including network firms, may be reluctant to participate in issuer audits due to the additional liability that may arise from having to consent to the inclusion of the audit firm's name in the auditor's report. This could particularly impact smaller firms, who are not part of a global network and may need to use non-network firms to conduct audit work.

Liability Considerations

The Proposal identifies a number of liability considerations, primarily related to Section 11, Section 10(b) of the Securities Exchange Act of 1934 (Section 10(b)) and Rule 10b-5 promulgated under it. The CAQ believes that increasing the risk of litigation exposure is neither in the spirit of, nor necessary to, enhancing transparency in the audit, particularly when there are alternative mechanisms that can achieve the increased transparency without raising the liability concerns, as further described in Appendix A. We believe our proposed alternative approaches may help mitigate the potential significant additional liability exposure inherent in the Proposal, while at the same time providing the proposed information to financial statement users, and we urge the PCAOB to consider these alternatives and not to proceed on the assumption that these liability concerns are limited, incidental, or manageable.

Alternative Approaches to the Auditor's Report

As previously noted, while the CAQ supports providing additional information to financial statement users to enhance their understanding of the auditor's role and responsibilities, including providing information on certain other participants in the audit, we do not believe the identification of the engagement partner will result in any incremental improvements in audit quality or provide meaningful information to financial statement users. However, should the Board move forward with the Proposal, we encourage the Board to consider the alternative approaches presented below, which we believe offer reporting mechanisms that would provide the information addressed within the Proposal, while mitigating many of the practical challenges and litigation concerns of providing this information in the auditor's report.

Form 2 Reporting

The CAQ continues to believe reporting in Form 2 is a more appropriate alternative to reporting in the auditor's report,[5] as it provides a convenient and accessible form of disclosure for financial statement users that is centralized in one location (i.e., the PCAOB's website). Most importantly, reporting in Form 2 would alleviate the requirement for obtaining consents from the engagement partner and certain other participants in the audits, who would otherwise be named in the auditor's report under the Proposal, and therefore, would mitigate many of the practical challenges and liability concerns noted above.

[5] Page 5, CAQ comment letter to the PCAOB dated January 9, 2012.

We appreciate the Board's concerns outlined in the Proposal regarding the use of Form 2 as an alternative reporting mechanism to the auditor's report. However, we believe a number of these concerns can be addressed, while meeting the Board's objective of providing financial statement users with timely useful information:

- Lack of Timely Information

The Board expressed concerns that since Form 2 must be filed no later than June 30 of each year, and covers the preceding 12-month period from April 1 to March 31, the disclosure of information to financial statement users would be delayed from three to fifteen months.[6] We believe this concern could be addressed by the Board amending the filing instructions for Form 2 to require audit firms to file specific Form 2 data (e.g., identification of engagement partner and certain other audit participant information) on a periodic basis, or alternatively, the Board could create a new PCAOB form with the applicable data to also be filed on a periodic basis. An additional benefit to providing the information outside the auditor's report, and allowing the information to be provided after the completion of the audit, would be that the auditor would not be assembling this information during the completion stage of the audit.

- Costs to Audit Firms

The Board expressed concerns regarding the additional costs accounting firms would incur to develop systems to compile and report the proposed information (e.g., engagement partner name and information related to certain other participants).[7] Regardless of the location of this information, we believe audit firms would incur initial costs to develop processes to gather the information and annual costs associated with ongoing maintenance efforts, and it is unclear how cost concerns could inhibit the consideration of Form 2 as an alternative. Further, audit firms already have established processes in place to gather information for Form 2 filings and annual inspection requests, which would limit the potential incremental costs and be less of a burden to audit firms, as compared to the overall costs associated with the process of obtaining consents if such information is included in the auditor's report.

- Convenience of Location

The Board suggested that Form 2 reporting would make it more difficult for financial statement users to locate the relevant information (e.g., engagement partner name and information related to certain other participants in the audit), because they would have to search for it in the midst of other unrelated information in Form 2, particularly for users who are only interested in the name of the engagement partner for a particular audit, rather than an aggregation of all of the firm's engagement partners.[8] However, we believe that Form 2 provides an accessible form of reporting, centralized in one location that would allow financial statement users to obtain information from one source, as opposed to searching in multiple filings. Further, the PCAOB's Form 2 provides a consistent data format that could allow for the development of additional systems (e.g., searchable databases) to make the information addressed in this Proposal more easily accessible to financial statement users.

Audit Committee or Proxy Statement Reporting

Audit committees play a critical role in the governance of public companies and in the integrity of the overall external financial reporting system. Under the Sarbanes-Oxley Act of 2002, audit committees of public

[6] Page 33, the Proposal.
[7] Ibid.
[8] Pages 33-34, the Proposal.

companies are broadly charged with overseeing a company's financial reporting process and for hiring, compensating, and overseeing the work of the external auditor.

Another potential alternative to reporting in the auditor's report is for the identification of the engagement partner and information on certain other participants involved in the audit to be provided in the audit committee report (or elsewhere within the proxy statement). For instance, if reported within the audit committee report, the audit committee could expand on the information and provide additional context related to their oversight responsibilities of the external auditor. Further, as this reporting would not require consents from the engagement partner and certain other participants in the audit, the consent concerns discussed above would also be mitigated. Finally, reporting in the audit committee report (or elsewhere within the proxy statement) would provide financial statement users, particularly shareholders, with information located within the central document required to be provided by issuers to solicit shareholder votes. This approach seems better aligned with the Board's views, particularly in cases where shareholders are asked to vote to ratify the company's choice of registered firm as its auditor.[9]

We understand the PCAOB does not have the authority to require the disclosure of such information within the audit committee report (or elsewhere within the proxy statement), as these disclosure requirements are governed by the SEC. However, if the Board continues to move forward with the Proposal, we encourage the PCAOB to work with the SEC to consider whether it is more appropriate for this information to reside within the proxy statement, either in the audit committee report or elsewhere.

Unintended Consequences of Identifying the Engagement Partner

The CAQ believes that, regardless of the location, there are unintended consequences of identifying the engagement partner that could result in financial statement users reaching inappropriate conclusions about the engagement partner, the audit firm, or the quality of the audit. For example, the execution of an effective audit involves the efforts of many individuals and is dependent on a system of quality controls that is in accordance with the PCAOB's Quality Control Standards. Audit firms have historically signed auditor's reports based upon these collective efforts, and we are concerned that the identification of the engagement partner (and perhaps the undue emphasis placed on such) will send a message that may be inconsistent with how financial statement users should view and evaluate the execution of an audit.

Financial statement users may also draw inappropriate inferences about the expertise and experience of the engagement partner without proper consideration of the important contributions of other members of the engagement team or consideration of the engagement partner's experience gained outside the public company audit environment that would not be subject to disclosure. Similar concerns may exist for first time signing partners on audits of issuers, as financial statement users would not have visibility into the audits of other issuers (or non-issuers) with which these engagement partners have been involved.

Additional Suggested Enhancements to the Disclosure of Certain Other Participants

As it relates to the use of audit hours as a measure to determine which participating audit firms must be named in the auditor's report, we appreciate the Board's inclusion of a range option, as a range approach provides transparency, but reduces the administrative burden during the critical stage of audit completion that could be imposed on the audit engagement team by requiring precise calculations for each audit participant and related reporting of certain participation rates. However, despite the inclusion of a range option, we believe there are possible implementation challenges associated with the use of audit hours as a metric, including accounting for audit hours incurred performing multi-purpose testing (e.g., statutory audits of subsidiaries performed abroad where the same work is also utilized for the consolidated issuer audit), and the

[9] Pages 3 and A3-3, the Proposal.

timing of when the calculation of participation percentages for certain audit participants would be performed during the audit completion stage. Although the alternative approaches discussed above would alleviate some of these concerns, by allowing the information to be assembled after the completion of the audit, we believe the profession would benefit from the PCAOB providing additional guidance on these implementation challenges.

Scope of the Proposal

Emerging Growth Companies (EGC)

The CAQ believes that the proposed amendments related to the disclosure of information about certain other participants in the audit (and the identification of the engagement partner, if the PCAOB decides to move forward with that aspect of the Proposal) should be applicable to the audits of EGCs. We believe EGCs exhibit characteristics similar to other public companies and financial statement users would benefit from similar reporting requirements.

Brokers and Dealers

In our view, non-issuer brokers and dealers should be excluded from the proposed amendments related to the disclosure of information about certain other participants in the audit (and the identification of the engagement partner, if the PCAOB decides to move forward with that aspect of the Proposal). As noted within the Proposal, the ownership of brokers and dealers is primarily closely held (per the PCAOB's Office of Research and Analysis, approximately 75% of the brokers and dealers have five or fewer direct owners), and the direct owners are generally part of the entity's management.[10] Accordingly, we believe that requiring the disclosure of information about certain other participants (and the identification of the engagement partner, if the PCAOB decides to move forward with that aspect of the Proposal) would not provide financial statement users of non-issuer brokers and dealers with additional relevant information to justify the incremental cost.

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The CAQ acknowledges the Board's efforts to further transparency in the audit through this Proposal. However, we do not believe the identification of the engagement partner will provide meaningful information to financial statement users or result in incremental improvements in audit quality. Further, we believe the unintended consequences and liability implications associated with identifying the engagement partner, most importantly under Section 11, must be carefully considered. Should the Board move forward with this aspect of the Proposal, we believe engagement partner identification in either Form 2 or the audit committee report (or elsewhere within the proxy statement), rather than the auditor's report, would be a more appropriate approach.

We support providing additional information on certain other participants involved in the audit. However, we do not believe this information should reside in the auditor's report, due to the practical challenges and liability considerations noted above. Should the Board move forward with the proposed amendments related to the disclosure of information about certain other participants in the audit, we encourage the Board to consider our suggested alternative approaches that would provide enhanced transparency, while mitigating many of the practical challenges and litigation considerations.

[10] Pages 26-27, the Proposal.

The CAQ appreciates the opportunity to comment on the Proposal and would be pleased to discuss our comments or answer any questions that the PCAOB staff or the Board may have regarding the views expressed in this letter.

Sincerely,

Cynthia M. Fornelli
Executive Director
Center for Audit Quality

cc:

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Appendix A – Liability Considerations

Note: This appendix presents the CAQ's views regarding the liability risks associated with the Proposal.

The Proposal states, with respect to identification of both the engagement partner and certain other participants in the audit, a number of liability considerations, primarily related to Section 11 of the Securities Act of 1933 (Section 11), Section 10(b) of the Securities Exchange Act of 1934 (Section 10(b)) and Rule 10b-5, promulgated under it. The Board further states that any possible increase in liability exposure for a named engagement partner or a participating audit firm, in connection with the issuance of a consent, would be limited, and that the potential risk of such an increase is justified by the potential benefits of greater transparency to investors and other financial statement users.[11]

We respectfully suggest, however, that the liability considerations are more significant than that acknowledged by the PCAOB, particularly as they relate to Section 11. As discussed more fully below, although it is not possible to quantify the magnitude of the incremental risk, we believe the Proposal will lead to an increase in litigation against named engagement partners and participating audit firms. However, this additional liability exposure could be avoided, or at least substantially mitigated, if the alternative disclosure approaches discussed above were adopted. Accordingly, we urge the PCAOB to consider these suggested alternatives and not proceed with an assumption that the liability concerns are limited, incidental, or manageable.

Section 11

Liability under Section 11 has broad impact, because any public offering of securities in the United States, including initial public offerings and bond offerings, must be conducted by means of a registration statement, and because of the requirement for a consent with respect to a post-effective amendment to a shelf registration (e.g., a Form 10-K that through incorporation by reference becomes part of the registration statement). Unlike Section 10(b), Section 11 does not require a plaintiff to prove causation or scienter. Generally, a Section 11 claim may be viable as long as the plaintiff can show that (i) he or she purchased securities pursuant to a registration statement, (ii) the registration statement contained a material misstatement or omission, (iii) the defendants are covered by the statute, and (iv) the complaint was timely. Section 11 balances this broad liability by limiting the scope of those who may be sued to a clearly-defined class of defendants, including experts such as accountants who "prepare" or "certify" portions of the registration statement.

The PCAOB appears to assume that, under the Proposal, Section 11 liability would substantially broaden the class of defendants to include the engagement partner and other participants who (under the Proposal) will be named in the auditor's report. While it could be argued that an engagement partner and the other named participating audit firms should not fall within the group for which consents would be required, few issuers are likely to risk the rejection of a filing on this basis. The necessary assumption in considering the Proposal is that Section 11 would, under the Proposal, be extended to engagement partners and participating audit firms that are named in the auditor's report, and that litigation against engagement partners and such firms would occur.[12]

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[11] Page 21, the Proposal.

[12] Notwithstanding the assumption made in the Proposal, the conclusion that consents of engagement partners and other participants will be required is not obvious. Neither individual engagement partners nor participating audit firms "prepare" or "certify" the audit report that is included in the registration statement; as the Proposal observes, "[t]he auditor's report would continue to be signed only by the firm." In this regard, we note that the Proposal misquotes the definition of "certified" in the SEC rules, stating that it applies to anyone who "examined *or* reported upon" the information, when the rule says certified means "examined *and* reported upon" 17 CFR § 230.405 (emphasis added).

While the Proposal contends that Section 11 lawsuits against accounting firms are "relatively rare," that observation understates their impact and severity. Section 11 lawsuits carry greater risk, because of the lighter burden for plaintiffs, and involve claims for significant dollar amounts.[13] Section 11 is the most draconian liability provision in the federal securities laws, and the CAQ believes that the potential Section 11 liability is greater than that acknowledged by the PCAOB in the Proposal.

Section 10(b) and Rule 10b-5

The Proposal notes that engagement partners and other participants in the audit could become liable under Section 10(b) and Rule 10b-5 for materially untrue statements deemed to be made by them in the auditor's report.[14] Section 10(b) is a general federal antifraud provision, applicable to all registered and unregistered securities transactions. The Proposal also suggests that participants' risk will be limited, due to the Supreme Court's decision in *Janus Capital Group, Inc. v. First Derivative Traders*, 131 S. Ct. 2296, 2302 (2011). The Court in *Janus* limited Section 10(b) liability to the "maker" of the fraudulent statement. If the Proposal is adopted, persons named in the auditor's report will argue that they are not "makers" of the statements in the report. While the CAQ believes that this is the better view, there will certainly be litigation, and resulting uncertainty, over that point if engagement partners and other participating audit firms are named in the auditor's report and consents are required.

State Laws

The CAQ believes that the legal implications under state law of naming individual engagement partners and participating audit firms are also an important consideration. State law negligence and fraud claims are often asserted against audit firms by, among others, litigation or bankruptcy trustees or receivers. Individual engagement partners are not typically named as defendants in such lawsuits, but the identification of the engagement partner in the auditor's report may change that. For instance, a state court may reach the conclusion that an engagement partner or other participating audit firm named in the auditor's report is liable under the state's laws. Additionally, unlike federal securities laws, a number of states' blue sky laws recognize causes of action by a holder of securities who claims to have relied on false statements. Further, while there is no private right of action for aiding and abetting a securities violation under federal law, there is such a right of action in many states. The consent filing requirement may also subject named foreign participants to jurisdiction in U.S. courts that would otherwise not exist. Foreign participants usually do not perform any significant audit activities within the United States, and the courts may find that there are not sufficient grounds for personal jurisdictional over these participants.[15] The filing of a consent with the SEC, however, could vitiate that argument, even where there is no increased activity in the United States by the foreign participant. As a result, even without reference to ultimate liability, identification of the engagement partner and participating audit firms could increase the number of state law claims brought against such partners and firms.

Increase in Litigation Costs

The Proposal states that the impact of a written consent likely would be minimal even if it leads to the naming of numerous additional defendants, on the grounds that the liability of the additional parties is "coextensive" with that of the firm.[16] Aside from the increased liability risks, this does not appear to consider the potential

[13] See generally WorldCom, Inc. Securities Litigation, 346 F. Supp. 2d 628 (S.D.N.Y. 2004).
[14] Page 24, the Proposal.
[15] See, e.g., CRT Investments, Ltd. v. BDO Seidman, LLP, 2011 WL 2225050 (N.Y. App. Div. June 9, 2011) (applying New York long-arm statute). See generally, New York Court Did Not Have Personal Jurisdiction Over Cayman Islands Accounting Firm That Audited Cayman Islands Feeder Fund for New York Fund, 36 Professional Liability Report art. 1 (July 2011). A jurisdictional issue might also arise in Section 10(b) lawsuits.
[16] Page 22, the Proposal.

increase in litigation costs that would result if the Proposal is adopted. For instance, adding defendants is likely to increase the issues in litigation and the number of counsel involved (e.g., separate counsel for the engagement partner and each participating audit firm that is named); lawsuits might also be brought in multiple jurisdictions, thereby further complicating matters. Additionally, although the Proposal states that liability would only attach to statements, "associated, in some way, with their own audit work,"[17] it could be challenging to determine what financial statement information each named participant might have "prepared" or "certified." Further, adding the engagement partner and participating audit firms to the lawsuit will almost certainly change litigation dynamics in ways that are adverse to audit firms and that have nothing to do with the merits or substance of the claims at issue. For example, a plaintiff can seek a settlement with one defendant in exchange for that defendant's assistance in pursuing the lawsuit against remaining defendants. With multiple defendants this could happen more frequently, especially when individuals can be named as defendants and pursued for exposures that could be personally catastrophic and that are today faced only by the audit firm. This would further increase potential liability or settlement costs.

The Proposal also suggests that, through indemnification, the firm may satisfy an adverse judgment against an engagement partner, stating, "… in most cases the accounting firm will have greater resources to satisfy a judgment than will any individual partner."[18] The CAQ believes that indemnification of an engagement partner by an audit firm would be appropriate and valid. But as the Proposal mentions in a footnote, the SEC has taken the position in other circumstances that indemnification against Securities Act liability is unenforceable.[19] The SEC's positions in this area have generally been in the context of indemnification by issuers of their directors and officers or underwriters, and the issue, to our knowledge, has not arisen in the context of indemnification by an accounting firm of its engagement partners.[20] Some courts have concluded, as to underwriters, that they should not be entitled to indemnity because the public depends on the work that they do.[21]

The question about enforceability of an indemnity is another potential issue under the Proposal that could be easily avoided by taking an alternative approach to achieving the transparency objective. Moreover, even a valid indemnity will provide little comfort to the defendant engagement partner, if the audit firm is not financially capable of honoring that indemnity. Even if (as one would hope) this would rarely happen, the mere possibility, coupled with the crippling liability the engagement partner would then likely have to face on his or her own, may well have consequences for how audit firms function, including the willingness to serve as engagement partners on issuers.

The CAQ believes that the reasons the Proposal gives for assuming that "the costs imposed by a consent requirement likely would be relatively low"[22] may not contemplate all of the factors discussed above, and the information called for in the Proposal could be provided without risking an extension of liability by making these disclosures in a location other than the auditor's report.

[17] Page 23, the Proposal.
[18] Page 22, the Proposal.
[19] Footnote 50, the Proposal.
[20] See No-action letter, PriceWaterhouse LLP (Oct. 3, 1995).
[21] See, e.g., Eichenholtz v. Brennan, 52 F.3d 478, 485 (1995); Laventhol, Krekstein, Horwath & Horwath v. Horwitch, 637 F.2d 672, 676 (1980).
[22] Page 22, the Proposal.