CENTER FOR CAPITAL MARKETS
COMPETITIVENESS

TOM QUAADMAN
VICE PRESIDENT

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July 28, 2014

Mr. Kevin O'Neill
Deputy Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Ms. Lynn Powalski
Deputy Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Securities and Exchange Commission (Release No. 34-72643; File No. PCAOB 2014-01) PCAOB Proposed Rules Related to Auditing Standard No. 18, *Related Parties,* Amendments to Certain PCAOB Auditing Standards Regarding Significant Unusual Transactions, and Other Amendments to PCAOB Auditing Standards.

Dear Mr. O'Neill and Ms. Powalski:

The U.S. Chamber of Commerce (the "Chamber") is the world's largest federation of businesses and associations, representing the interests of more than three million U.S. businesses and professional organizations of every size and in every economic sector. These members are both users and preparers of financial information. The Chamber created the Center for Capital Markets Competitiveness ("CCMC") to promote a modern and effective regulatory structure for capital markets to fully function in a 21st century economy. The CCMC believes that businesses must have a strong system of internal controls and recognizes the vital role external audits play in capital formation. The CCMC supports efforts to improve audit effectiveness and appreciates the opportunity to comment on Securities and Exchange Commission's ("SEC") review of the Public Company Accounting Oversight Board

("PCAOB") *Proposed Auditing Standard – Related Parties, Proposed Amendments to Certain PCAOB Auditing Standards Regarding Significant Unusual Transactions, and Other Proposed Amendments to PCAOB Auditing Standards* ("the Proposal").

The CCMC commends the PCAOB's dedication to performing economic analysis in their standard setting process and realize that these efforts are still in the early stages of development. The CCMC recognizes that Appendix 5 of the Proposal, titled "Economic Considerations, including for Audits of Emerging Growth Companies," contains a lengthy narrative generally organized in form consistent with the PCAOB's *Staff Guidance on Economic Analysis in PCAOB Standard Setting* ("Staff Guidance") dated February 14, 2014.

Nevertheless, the CCMC has serious concerns regarding the substance of the economic analysis and consideration of cost benefit analysis upon Emerging Growth Companies ("EGC"), as required under the Jumpstart our Business Startups Act ("JOBS Act") and the PCAOB's own Staff Guidance, under the Proposal as finalized by the PCAOB. Namely, we do not believe that the PCAOB has done a thorough analysis as required by the JOBS Act; and, we believe that the Proposal fails to meet the threshold required by law. The CCMC has expressed these concerns in previous comment letters[1] ("2012 CCMC comment letter" and "2013 CCMC comment letter") and in our opinion those concerns have not been considered or addressed by the PCAOB. Accordingly, we have attached our previous comment letters to reiterate these issues for the record.

The CCMC recommends that the SEC return the Proposal to the PCAOB for a cost benefit analysis that complies with the JOBS Act and allows stakeholders to understand the costs and benefits as the Proposal is considered for approval in the SEC's rulemaking process.[2]

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[1] *See* the May 30, 2012 and July 8, 2013 letters from the United States Chamber of Commerce Center for Capital Markets Competitiveness on the PCAOB *Proposed Auditing Standard – Related Parties, Proposed Amendments to Certain PCAOB Auditing Standards Regarding Significant Unusual Transactions, and Other Proposed Amendments to PCAOB Auditing Standards* (PCAOB Release No. 2012-001, February 28, 2012 and PCAOB Rulemaking Docket Matter No. 038).

[2] The CCMC's concerns regarding the PCAOB's cost-benefit analysis are not unique to this Proposal. The CCMC directs the SEC to also consider the CCMC's concerns with the PCAOB's economic analysis which are also contained in a March 10, 2014 comment letter from the CCMC to the PCAOB on the PCAOB Exposure Draft on *Improving the Transparency of Audits: Proposed Amendments to PCAOB Auditing Standards to Provide Disclosure in the Auditor's Report of Certain*

Section 103(a) (3) of the JOBS Act requires that rules adopted by the PCAOB after the date of enactment of JOBS shall not apply to an audit of any EGC, unless the SEC determines that the application of such additional requirements is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation.

The initial Proposal failed to provide such an analysis and in the 2012 CCMC comment letter we stated:

> **[C]ommenters are therefore unable to ascertain what the estimated costs are and the burdens that will be placed upon businesses and auditors as a result of the Proposal. This inhibits the ability of commenters to provide the PCAOB with a fully informed analysis that could lead to beneficial changes in the Proposal.**

In the 2013 CCMC comment letter we stated that the economic analysis contained in the Proposal was flawed because it was composed of a number of assertions that were generic and speculative in nature. Further, the analysis was centered upon the size, and maturity of EGC's but did not provide any data on costs. This analysis failed to articulate a study to determine an economic baseline against which to measure the Proposal's economic impact. The CCMC also noted the failure by the PCAOB to provide a substantive analysis of the proposed requirements on EGC's or potential alternatives to the Proposal. Finally, the 2013 CCMC comment letter stated:

> **As a result the Proposal adds to audit complexity and raises doubt that the proposed requirements would be cost/benefit effective.**

The SEC release of the Proposal, as provided by the PCAOB, does not address these flaws and again provides no data on costs.

Participants in the Audit (PCAOB Release No. 2013-009, December 4, 2013; PCAOB Rulemaking Docket Matter No. 029).

The CCMC must also take exception with assertions made in the Proposal that specific concerns about efficiency, competition and capital formation were not received[3] and that no commenters stated that the Proposal should not apply to the audits of EGCs.[4] We believe that this mischaracterizes the record as the CCMC in the 2012 and 2013 CCMC comment letters[5] stated that the Proposal failed to provide commenters with an appropriate economic analysis to ascertain the impacts of the Proposal and met the minimum thresholds required by the JOBS Act.

Accordingly, the CCMC recommends that the SEC return the Proposal to the PCAOB with instructions to issue an analysis that commenters can ascertain the Proposal as it is considered in the SEC rulemaking process and comply with the thresholds required in the JOBS Act.

We are happy to discuss these concerns in greater detail.

Sincerely,

Tom Quaadman

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[3] *See* Page 246 of the Proposal
[4] *See* Page 253 of the Proposal
[5] It should also be noted that the 2013 CCMC comment letter also incorporates by reference the concerns raised in the 2012 CCMC comment letter.

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July 8, 2013

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

Re: PCAOB *Proposed Auditing Standard—Related Parties, Proposed Amendments to Certain PCAOB Auditing Standards Regarding Significant Unusual Transactions, and Other Proposed Amendments to PCAOB Auditing Standards* (PCAOB Release No. 2013-004, May 7, 2013, and PCAOB Rulemaking Docket Matter No. 038)

Dear Ms. Brown:

The U.S. Chamber of Commerce (the "Chamber") is the world's largest federation of businesses and associations, representing the interests of more than three million U.S. businesses and professional organizations of every size and in every economic sector. These members are both users and preparers of financial information. The Chamber created the Center for Capital Markets Competitiveness ("CCMC") to promote a modern and effective regulatory structure for capital markets to fully function in a 21st century economy. The CCMC believes that businesses must have a strong system of internal controls and recognizes the vital role external audits play in capital formation. The CCMC supports efforts to improve audit effectiveness and appreciates the opportunity to comment on the Public Company Accounting Oversight Board ("PCAOB") *Proposed Auditing Standard—Related Parties, Proposed Amendments to Certain PCAOB Auditing Standards Regarding Significant Unusual Transactions, and Other Proposed Amendments to PCAOB Auditing Standards* ("the Proposal").

We commend the PCAOB's consideration of the comments on the February 2012 exposure draft and taking action to addressing some of those issues. However, not all of our concerns are fully addressed in the Proposal and we have attached our previous comment letter to reiterate these issues for the record. Additionally, this letter will further elaborate our concerns regarding the Proposal.

Discussion

The Proposal is the second time the PCAOB has released for comment a proposed auditing standard on related parties and proposed amendments on auditing significant unusual transactions and financial relationships and transactions with executive officers. The PCAOB received 37 comment letters on the initial exposure draft issued in February 2012. The CCMC provided comments on the initial exposure draft.[1]

I. Cost Benefit Analysis

The PCAOB's February 2012 exposure draft did not contain a cost-benefit analysis. Thus, the CCMC's letter of May 30, 2012 noted:

> [T]**hat commenters are therefore unable to ascertain what the estimated costs are and the burdens that will be placed upon businesses and auditors as a result of the Proposal. This inhibits the ability of commenters to provide the PCAOB with a fully informed analysis that could lead to beneficial changes in the Proposal.**

The Proposal recognizes that the 2012 Jumpstart Our Business Startups Act (JOBS) now makes economic analysis a necessary pre-condition for applying new PCAOB auditing standards to an audit of any emerging growth company (EGC). Specifically, JOBS Section 103(a) (3) requires that rules adopted by the Board after the date of enactment of JOBS shall not apply to an audit of any EGC, unless the Commission determines that the application of such additional requirements is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation.

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[1] *See* the May 30, 2012 letter from the United States Chamber of Commerce Center for Capital Markets Competitiveness on the PCAOB *Proposed Auditing Standard – Related Parties, Proposed Amendments to Certain PCAOB Auditing Standards Regarding Significant Unusual Transactions, and Other Proposed Amendments to PCAOB Auditing Standards* (PCAOB Release No. 2012-001, February 28, 2012 and PCAOB Rulemaking Docket Matter No. 038).

The CCMC recognizes that one reason the PCAOB issued this second exposure draft is to solicit information on the estimated costs and burdens that will be placed upon businesses and auditors as a result of the Proposal, and to solicit other information on how the Proposal would contribute to investor protection and promote efficiency, competition, and capital formation. For example, of the 50 questions included in the Proposal on which the Board requests comments, at least 24 relate to economic considerations, including audits of EGCs.

Further, the CCMC recognizes that the Proposal does not represent a final standard. Thus, additional evidence and analysis will need to be collected and analyzed any ensuing standard adopted by the Board and submitted for approval by the Securities and Exchange Commission ("SEC").

Nonetheless, given the information available in the Proposal, in particular information in Section IV on "Economic Considerations, Including Audits of Emerging Growth Companies,"[2] the CCMC has concerns about elements of the PCAOB's approach to economic analysis and the nature and substance of that analysis.

The Proposal includes a number of assertions as part of the PCAOB's economic analysis.[3]

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[2] *See* page A4-96 through A4-117 in the Proposal.

[3] As an example, the following assertions can be found on pages A4-96, A4-97, A4-99 and A4-104 of the Proposal:

- The proposed auditing requirements *have the potential* to enhance audit quality in ways that could also enhance the quality of a company's financial reporting and, therefore, they *could*:
  - Reduce information asymmetry between companies and investors because they *may*
    - improve the auditor's identification and assessment of risks of material misstatement of financial statements and response to those risks, which *may* lead to higher quality accounting and disclosures for investors
    - result in a more meaningful exchange of information between the auditor and a company's audit committee
  - Reduce the cost of capital for issuers
- The Proposal reflects a risk-based and scaled approach because the audit procedures performed and, therefore, the associated costs are commensurate with the risks of material misstatement
  - Thus, companies *without* extensive relationships or transactions with related parties, significant unusual transactions, or financial relationships and transactions with the company's executive officers would not be expected to incur a significant change in audit costs
- The Proposal is necessary to align PCAOB auditing standards on transactions and relationships with related parties, significant unusual transactions, and relationships and transactions with executive officers with the PCAOB's suite of risk assessment standards (AS 8 through AS 15)
- Other auditing standards-setters have revised their requirements on related parties, for example:
  - The International Auditing and Assurance Standards Board ("IAASB") issued a revised standard in July 2008
  - The Auditing Standards Board ("ASB") issued a revised standard in October 2011

Many of these assertions are generic or speculative and are not linked to the elements of the Proposal. In fact, they could be made for almost any proposed auditing standard regardless of topic or substance. It appears to the CCMC, therefore, that the Proposal fails to explicitly articulate any appropriate economic baseline against which to measure the proposed requirements likely economic impact.

The CCMC appreciates that the Proposal does attempt to reference various types of evidence as support for revising audit standards, but fails to provide specifics for how it relates to the Proposal itself.[4]

The Proposal states that the PCAOB determined 579 SEC registrants have identified themselves as EGCs as of November 15, 2012. This number is up from the 196 EGCs noted in the PCAOB's economic analysis for AS No. 16, *Communications with Audit Committees*, sent to the Commission on August 28, 2012. The Proposal provides some general descriptive data about EGC's, which reveal that EGCs are a diverse group and generally appear to be companies new to the SEC reporting process.[5] Based on these data, the Proposal briefly suggests qualitative-type conjectures related to information asymmetry, investor confidence, competition, and costs. However, the Proposal contains no substantive analysis of the economic impact of the proposed requirements on EGCs, EGCs vis-à-vis other companies, or

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[4] For example see the following that can be found at page 5, A4-96, A4-98, A4-99, A4-114, of the Proposal:

- An analysis of alleged audit failures from 1997-2003 by the Quality Control Inquiry Committee largely involves cases before The Sarbanes-Oxley Act of 2002 ("SOX") and before a number of other legislative, regulatory, and standard-setting actions over the last decade.
- General references to instances of fraudulent financial reporting involving related party transactions, significant transactions outside the normal course of business, and transactions and relationships with executives include cases prior to SOX and prior to the promulgation of revised auditing standards such as Statement of Auditing Standard No. 99 on *Consideration of Fraud in a Financial Statement Audit* (December 15, 2002).
- References to two PCAOB 4010 reports on inspection results from 2004-2006 and 2007-2010 for tri-annually inspected audit firms issued February 25, 2013 and October 22, 2007, respectively, report that inspection deficiencies involved related parties, but the Proposal
  - Does *not* provide any specificity about the number of instances;
  - Does *not* discuss any root cause analysis in order
    - To rule out that the observed deficiencies related to problems with auditor performance;
    - To provide support that the observed deficiencies related to gaps in auditing standards and the proposed requirements would address these identified deficiencies.
- Settled SEC enforcement actions and PCAOB disciplinary actions to date which, by their very nature, would seem to indicate auditor performance problems rather than gaps in auditing standards.

[5] *See* pages A4-112 through A4-115 in the Proposal. The Proposal also reports that a review of 450 audited financial statements from a self-identified sample of EGCs indicates that 54 percent disclosed at least one related party transaction (see footnote 94 on page A4-115 in the Proposal.)

companies generally, although the CCMC appreciates that the Proposal does request commenters views and empirical evidence on these issues.[6]

Finally, the Proposal does not adequately address potential alternatives to the proposed requirements. The CCMC appreciates that the Board issued Staff Audit Practice Alert No. 5, *Auditor Considerations Regarding Significant Unusual Transactions* (April 7, 2010) ("Staff Alert") before deciding to issue its initial proposal. However, the Proposal fails to discuss or provide evidence on why this Staff Alert was inadequate.

As another example of the lack of evidence on the consideration of potential alternatives, the PCAOB provides a comparison of significant differences among the objectives and requirements of this Proposal versus other analogous standards of the IAASB and ASB.[7] However, this comparison contains no analysis of or rationale for why the PCAOB chose not to converge the proposed auditing requirements with those of the IAASB and ASB. As a result, the Proposal adds to audit complexity and raises doubt that the proposed requirements would be cost/benefit effective.

II. CCMC Recommendation

The CCMC appreciates that the PCAOB faces challenges in doing economic analysis for auditing standards. However, the concerns just discussed suggest that all stakeholders would be well served if the PCAOB would reconsider its approach to economic analysis.

The CCMC suggests that the PCAOB needs an appropriate and transparent framework for economic analysis—one that will serve as a template for such analysis across all PCAOB rulemaking initiatives. One example of such a framework is the SEC staff memorandum, "Current Guidance on Economic Analysis in SEC Rulemakings" dated March 16, 2012.

Thus, the CCMC recommends that the PCAOB develop guidance on economic analysis for PCAOB rulemaking. Once developed, the PCAOB should expose the framework for public comment and the finalized framework should be

[6] *See* page A4-115 in the Proposal.
[7] *See* Appendix 5 in the Proposal.

publicly disclosed. As a starting point, the PCAOB could consider adapting the framework in the SEC staff memorandum to an audit context.

III. Other Matters

Similar to the prior exposure draft, the Proposal includes proposed amendments to existing PCAOB auditing standards that would add requirements for auditors to perform procedures to obtain an understanding of the company's financial relationships and transactions with its executive officers, including executive compensation. The intent of this added requirement is to assist the auditor in identifying and assessing risks of material misstatement—not to call into question the policies and procedures of the company. However, the CCMC previously expressed concern that media coverage of the proposed amendments indicated that the PCAOB's intent was not well understood and that an expectation gap was being created.

We appreciate that the PCAOB acknowledged this problem and revised the wording of the proposed amendment to paragraph 10A of Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement*. This revision partially reflects wording suggested in our previous comment letter. Notwithstanding this revision, we continue to recommend that the PCAOB include more expansive language in the standard itself to provide clarity on intent and to avoid problems down the road. The language recommended in our prior letter, including a statement that "these audit procedures are not intended to call into question the policies and procedures of the company …," could be added as a note to paragraph 10A.

Finally, the Proposal now states that the Board anticipates the proposed standard and proposed amendments would be effective for audits of financial statements for fiscal years beginning on or after December 15, 2013. This proposed effective date is not unreasonable as long as the PCAOB adopts and the SEC approves a final standard before the end of 2013.

Conclusion

Once again, the CCMC appreciates the opportunity to comment on the Proposal. Thank you for your consideration and the CCMC stands ready to assist in these efforts.

Sincerely,

Tom Quaadman

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May 30, 2012

Ms. Phoebe W. Brown
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Re: PCAOB *Proposed Auditing Standard – Related Parties, Proposed Amendments to Certain PCAOB Auditing Standards Regarding Significant Unusual Transactions, and Other Proposed Amendments to PCAOB Auditing Standards* (PCAOB Release No. 2012-001, February 28, 2012 and PCAOB Rulemaking Docket Matter No. 038)

Dear Ms. Brown:

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The CCMC believes that businesses must have a strong system of internal controls and recognizes the vital role external audits play in capital formation. The CCMC supports efforts to improve audit effectiveness and appreciates the opportunity to comment on the Public Company Accounting Oversight Board ("PCAOB") *Proposed Auditing Standard – Related Parties, Proposed Amendments to Certain PCAOB Auditing Standards Regarding Significant Unusual Transactions, and Other Proposed Amendments to PCAOB Auditing Standards* ("the Proposal").

The CCMC has some concerns about various aspects of the proposal, particularly the possibility of creating an expectation gap, possible overreach into corporate governance, use of release text and a failure to provide a cost benefit analysis. The CCMC believes that some minor additions could resolve the potential expectation gap and believes that the PCAOB should discuss the proposal with the various regulators that are considering or will soon propose executive compensation related regulations.

The CCMC concerns are discussed in more detail below.

I. Executive Compensation

The CCMC has long advocated that the PCAOB review existing auditing standards and make revisions to them if needed. So at the outset we are pleased that the PCAOB has undertaken the opportunity to review the existing standards and release the Proposal.

The Proposal includes proposed amendments to existing PCAOB auditing standards that would add requirements for auditors to perform procedures to obtain an understanding of the company's financial relationships and transactions with its executive officers, including executive compensation. While the Proposal states that the intent of this added requirement is to assist the auditor in identifying and assessing risks of material misstatement, media coverage of both the PCAOB's open meeting on February 28, 2012 and the Proposal itself reveals that this intent is not well understood. Indeed, the Proposal appears to be creating an expectation gap in regards to the auditor's role and responsibilities related to executive compensation.

Such an expectation gap can sow confusion amongst auditors, investors and businesses and frustrate the intent of the PCAOB in issuing the proposal. To help mitigate this gap, it might be useful to include the following statement from release text in the rule itself (perhaps as a footnote):

> *These proposed audit procedures are not intended to call into question the policies and procedures of the company, but rather to assist the auditor in identifying and assessing risks associated with a company's financial relationships and transactions with its executive officers,*

including unrecognized compensation, illegal acts, or other matters (e.g., self-dealing or conflicts of interest).[1]

The Proposal also states that the procedures the auditor should apply with respect to executive compensation include reading proxy statements and other relevant company filings with the Securities and Exchange Commission ("SEC"). However, the proxy statement would likely be drafted and certainly would be filed subsequent to the completion of the audit. And, the executive compensation sections of the annual proxy statement largely contain historical information—that is compensation information related to the most recent period for financial statements included in Form 10-K filed with the SEC. It would seem that executive compensation information contemporaneous with the period under audit would be most useful for informing the auditor's identification and assessment of risk of material misstatement. Thus, while there may be other reasons for the auditor to read the proxy statement, it is not clear how doing so would accomplish the stated purpose with respect to executive compensation.

While we acknowledge that the Proposal is based upon and revising existing audit standards, the CCMC has expressed concerns regarding the possible encroachment of the PCAOB into areas of corporate governance that is within the purview of state corporate law, or under federal legislation, such as the Sarbanes-Oxley Act ("SOX") within the jurisdiction of the SEC. Under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") the SEC is involved in or expected to propose a series of regulations on executive compensation including incentive based compensation in the financial services industry, pay for performance disclosures, pay ratio disclosures and independent compensation committees. The proposed incentive based compensation regulation is a joint rulemaking of several financial regulators.

The CCMC of course believes that the PCAOB should act within the bounds of its jurisdiction. However, we believe that the PCAOB should also coordinate with these regulators to understand how the proposals interacts with expected regulatory changes and if any changes to the proposal should be made as a result.

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[1] See *Proposed Auditing Standard – Related Parties, Proposed Amendments to Certain PCAOB Auditing Standards Regarding Significant Unusual Transactions, and Other Proposed Amendments to PCAOB Auditing Standards ("Release")* Page A4-44.

Finally in regards to executive compensation, the Proposal maintains the PCAOB's existing audit requirements regarding the auditor obtaining an understanding of compensation arrangements with senior management other than executive officers. However, in doing so, the PCAOB needs to provide clarity on what is meant by senior management. While the Proposal includes a definition of executive officers, it does not define senior management or indicate how senior management would differ from executive officers (and existing auditing standards do not either).

II. Use of Release Text

The CCMC is concerned, as we have written before,[2] about the use of release text to modify a standard and provide guidance and interpretations not found in the standard itself. One very important example of this in the Proposal involves the objective of the proposed related party standard.[3]

Certainly an objective can guide the PCAOB in developing and drafting a proposed standard and, as such, would also guide the auditor in complying with a promulgated standard. However, instead of articulating that complying with the requirements of the proposed standard would meet the objective of the standard, the release text of the Proposal suggests that the auditor must somehow exercise judgment to meet the objective of the standard over and above complying with the requirements of the standard itself.

Essentially the release text articulates a policy statement with regards to an objective, which is not only new but inconsistent with previous statements by the PCAOB. Such a statement is misplaced in the release text of an exposure draft. Moreover, it would require open, thorough, and transparent due process before being articulated as a policy. The notions articulated in the release text appear to open the

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[2] For example, see the March 2, 2010 letter from the United States Chamber of Commerce Center for Capital Markets Competitiveness to the PCAOB on the *Proposed Auditing Standards Related to the Auditor's Assessment of and Response to Risk* (PCAOB Rulemaking Docket Matter No. 026) and the February 29, 2012 letter from the United States Chamber of Commerce Center for Capital Markets Competitiveness to the PCAOB on the *Proposed Auditing Standard Related to Communications with Audit Committees* (PCAOB Rulemaking Docket Matter No. 030).

[3] See release Page A4-4.

door to enabling PCAOB inspections to generate deficiencies and to otherwise extend auditor liability. The CCMC cannot support such notions.

As we have previously stated, the CCMC recognizes that the release text has merit, particularly in exposure drafts of proposed standards, as it can facilitate better public input. Nonetheless, since release text in any final standard will be referenced by plaintiff attorneys, PCAOB inspectors, and other regulators as a touchstone for the PCAOB's intent, we encourage the PCAOB to be very cautious and transparent in crafting release text for adopting standards.

Finally, there are examples provided in release text of the Proposal that should be included in the standard itself. To illustrate, the release text includes examples of other procedures performed during an audit that may help with the identification of significant unusual transactions.[4] These examples should be included in the amendments proposed to AU sec. 316 *Consideration of Fraud in a Financial Statement Audit* (pp. A2-6 and 7).

III. Significant Unusual Transactions

Proposed amendments to existing auditing standards in the Proposal would change the definition of significant unusual transactions. For example, currently AU sec. 316.66 states:

> ***Evaluating the business rationale for significant unusual transactions.*** *During the course of the audit, the auditor may become aware of significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual given the auditor's understanding of the entity and its environment. The auditor should gain an understanding of the business rationale for such transactions and whether that rationale (or lack thereof) suggests that the transactions may have been entered into to engage in fraudulent financial reporting or conceal misappropriation of assets.*

On the other hand, the Proposal would replace the existing paragraph with the following:

[4] Ibid, Page A4-33

> ***Evaluating whether the business purpose for significant unusual transactions indicates that the transactions may have been entered into to engage in fraud.*** *Significant transactions that are outside the normal course of business for the company or that otherwise appear to be unusual due to their timing, size, or nature ("significant unusual transactions") may be used to engage in fraudulent financial reporting or misappropriation of assets.*[5]

Not only does the Proposal eliminate the touchstone for "unusual" based on the entity and its environment, but release text goes on to explain that significant unusual transactions need not be infrequent, rather a significant unusual transaction could occur quarterly or more frequently.[6] On the face of it, this appears counter-intuitive and will likely contribute to ambiguity down the road about what constitutes a significant unusual transaction.

An additional problematic aspect of the proposed amendments related to significant unusual transactions includes the expanded list of factors (from AU sec. 316.67) that the auditor should evaluate as to the business purpose of significant unusual transactions (pp. A2.7 and 8). For example, the factor *an accounting for a transaction that enables the company to achieve certain financial targets* is a broad catch-all that could sweep-in a variety of unintended transactions.

IV. Other Matters

The Proposal states the Board anticipates that the proposed standard and proposed amendments would be effective for audits of financial statements for fiscal years beginning on or after December 15, 2012. This proposed effective date is not unreasonable as long as the PCAOB adopts and the SEC approves a final standard before the end of 2012.

V. Cost Benefit Analysis

The Proposal does not contain a cost-benefit analysis and commenters are therefore unable to ascertain what the estimated costs are and the burdens that will be

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[5] Ibid, Page A2-6

[6] Ibid Page A4-30. An additional subtlety here is that the Proposal appears to turn significant unusual transactions from an indicator of a fraud risk (see AU sec. 316.85) to a fraud risk per se.

placed upon businesses and auditors as a result of the proposal. This inhibits the ability of commenters to provide the PCAOB with a fully informed analysis that could lead to beneficial changes in the Proposal.

Concluding Remarks

Once again, the CCMC appreciates the opportunity to comment on the Proposal. We believe that the proposal is an important step in reviewing existing standards and revising them if needed.

While the CCMC has concerns regarding the Proposal, we believe that improvements can be made to reduce the expectation gap and provide clarity for all stakeholders involved in financial reporting and that comments to the Proposal would be more informed with a public cost-benefit analysis. Also, the CCMC believes that the PCAOB should have discussions with regulators concerning executive compensation regulations currently under consideration and that the PCAOB should avoid any potential over-reach into executive compensation and corporate governance regulation.

Thank you for your consideration and the CCMC stands ready to assist in these efforts.

Sincerely,

Tom Quaadman