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Advisory Committee on the Auditing Profession
Office of Financial Institutions Policy
Room 1418
Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Dear Committee Members:

Deloitte LLP is pleased to respond to the request for comments from the U.S. Treasury Advisory Committee on the Auditing Profession (the "Committee") regarding its recommendations in the *Second Draft Report—July 22, 2008* (the "July 22nd Report").

Overall, we continue to have the same primary concern expressed in our June 27, 2008 letter[1] - the Committee's draft Report does not adequately address the catastrophic litigation risk confronting the profession. In general, however, we recognize that the Committee has dedicated significant time and effort to this process and to the consideration of comments received on its *Draft Report – May 5, 2008* and *Addendum to VI. Firm Structure and Finances.* Therefore, we are not repeating comments on those draft recommendations as described in our June 27th letter, although our comments are still applicable. Rather, we offer here only specific additional comments on selected revised recommendations.

I. <u>Human Capital</u>

Although we have no further comments on individual Human Capital recommendations as revised in the July 22nd Report, we want to reinforce the importance of the profession's ability to attract and retain talent to the sustainability of the profession. While we believe it will continue to be difficult to attract and retain top talent in an environment where audit firms continue to face catastrophic litigation risk, we nonetheless believe that, taken as whole, the Human Capital recommendations will assist the profession, as well as contribute to an increased "awareness of the difficulty and importance of accounting."[2]

We believe the Committee could further assist the profession's ongoing efforts to attract and retain top talent if, in addition to making recommendations for improvement, it were to acknowledge the deep commitment the profession has already demonstrated towards human capital issues. As the Committee has noted during various discussions at its public meetings, the profession has some of the most progressive programs in this area among all businesses and the results of the profession's efforts have been recognized widely, including by such national publications and organizations as BUSINESS WEEK, FORTUNE, WORKING MOTHER MAGAZINE, Catalyst, Diversity Inc., and The Human Rights Campaign. We would be happy to provide the Committee

[1] *See* Written Submission of Deloitte LLP (June 27, 2008) at 1, available at http://comments.treas.gov/_files/DeloitteLLPCommentLetter.pdf.
[2] *See* Chairman Paul A. Volcker, Advisory Comm. Meeting Webcast at 16:08 m (July 22, 2008).

with more details on these programs if it would be helpful to further the record in support of such a recommendation in the final report.

II. Firm Structure and Finance

The Firm Structure and Finance subcommittee has deliberated many difficult and controversial issues related to the sustainability of the auditing profession. While we commend the level of attention and effort around these issues, we offer specific comments below on selected recommendations as revised in the July 22nd Report.

Recommendation 5. Urge the PCAOB to undertake a standard-setting initiative to consider improvements to the auditor's standard reporting model. Further, urge that the PCAOB and the SEC clarify in the auditor's report the auditor's role in detecting fraud under current auditing standards and further that the PCAOB periodically review and update these standards.

We note that the Committee has combined the two previously exposed recommendations regarding changes to the auditor's report into this new recommendation. We agree that consideration should be given to changes to the auditor's report, whether with regard to the auditor's role in detecting fraud or otherwise, and that such consideration should be done comprehensively rather than piecemeal.

The Committee's commentary highlights the various, and sometimes competing, ideas about whether and how to change the form of the auditor's report and/or the scope of auditor's work. This serves to underscore the need for the SEC and PCAOB to engage in careful consideration of the many significant related issues before engaging in rulemaking or standard setting in this area. As we discussed in our June 27th letter, we believe this should include: coordinating efforts with the Auditing Standards Board and International Auditing and Assurance Standards Board, which together have already commissioned four independent research studies on this issue; considering the potential legal ramifications to auditors and companies of various alternative reporting models; and considering whether additional information would be more effectively conveyed in the auditor's report, the company's disclosure, or a combination thereof.

The Committee's commentary advocates many of these steps, and we urge the Committee to clarify in the recommendation itself the need for careful consideration of the results of further study before a definitive determination can be made that rulemaking or standard setting is needed to change the reporting model.

Recommendation 7. Urge the PCAOB to require that, beginning in 2010, larger auditing firms produce a public annual report incorporating (a) information required by the EU's Eighth Directive, Article 40 Transparency Report deemed appropriate by the PCAOB, and (b) such key indicators of audit quality and effectiveness as determined by the PCAOB in accordance with Recommendation 3 in Chapter VI of this Report. Further, encourage the PCAOB to require that, beginning in 2011, the larger auditing firms file with the PCAOB on a confidential basis audited financial statements.

We continue to believe that recommended disclosures should focus on ways to inform various stakeholders about audit quality. As the Committee notes, much of the information required by Article 40 of the European Union's Eighth Company Law Directive[3] is appropriately focused on audit quality. Barry Salzberg testified on February 4th that we as a firm stand ready to make equivalent public disclosures. Moreover, we believe that

[3] European Union, Eighth Company Law Directive, Directive 2006/43/EC.

as investors, audit committees and other users gain familiarity with these types of disclosures, they can be tailored and expanded in ways that will better inform various stakeholders about audit quality.

If the PCAOB determines to seek, for its own use, financial statements from registered firms, as discussed in our June 27th letter we do not believe such financial statements should be subject to an audit requirement. The potential competitive issues and costs associated with conducting audits of firms' financial statements would not be justified for a confidential submission to the PCAOB. Nor do we believe that a requirement to submit audited financial statements would have any direct link to improving audit quality. In addition, if the PCAOB requires registered firms to submit financial information, we would urge that it require the submission under its inspection program so that such information is protected from discovery.

Litigation.

We understand from the Committee's July 22nd meeting that it intends to include a summary of its deliberations related to the catastrophic liability threat facing the profession in the final Report, even though it cannot reach consensus on recommendations to address that threat. As we discussed in our June 27th letter, we are disappointed that the Committee has not reached consensus on such recommendations. We nonetheless believe that a balanced summary of the Committee's discussion on this point in the final report could be important so that other policy makers, including the U.S. Congress, can have the benefit of the Committee's work when they consider this issue in the future.

In addition, as we also discussed in our June 27th letter, we do not believe the Committee has fully considered that its recommendations, if implemented, will function in an increasingly global capital markets environment. Orderly functioning of global markets depends on the sustainability of the global audit networks. Globalization demands global consistency where practicable, in order to allow the network of firms to continue to function effectively. This reality is important to the credibility of the Committee's efforts and the ultimate durability and usefulness of the recommendations themselves. We continue to believe that the recommendations around limitation of civil liability of auditors and audit firms included in the European Commission's recent Report *Recommendations Concerning the Limitation of the Civil Liability of Statutory Auditors and Audit Firms* is a significant development and one that should be given prominence by the Committee in its discussion of the liability issues in its final Report. We continue to believe that the disparity between the U.S. and European environment will only grow more marked as EU member states act on the EC's recommendations. This potential disconnect would happen at a time when the U.S. can ill-afford to fall behind the global markets.

III. Concentration and Competition

We agree with the Committee that the auditing profession benefits from a competitive population of auditing firms. We offer specific comments below on selected recommendations as revised in the July 22nd Report.

Recommendation 1. Reduce barriers to the growth of smaller auditing firms consistent with an overall policy goal of promoting audit quality. . . .
(a) Require disclosure by public companies in their registration statements, annual reports and proxy statements of any provisions in agreements with third parties that limit auditor choice.
(b) Include representatives of smaller auditing firms in committees, public forums, fellowships, and other engagements.

We continue to believe these recommendations will help improve competition within the auditing profession and support their adoption. However, we urge the Committee to reconsider the addition of language to its commentary that suggests “costs associated with public companies’ changing auditors … can pose another barrier for smaller firms trying to enter the larger public company audit market.”[4] The Committee supports this commentary with two sources, one of which is anonymous, which makes it difficult to assess its credibility. Moreover, both sources provide only anecdotal comments and generalizations around the issue, apparently without consideration of the many complicating factors that contribute to fees charged by predecessor auditors to reissue an audit opinion on previously filed financial statements.

There is no evidence presented to support the statement that the “top audit firms make it hard for a small public company to make a cost effective switch to a second tier firm.”[5] And there is no evidence to support the statement that “the former large audit firm charges a high fee to reconfirm or reissue the previous opinions as a sort of exit penalty.”[6] In reality, there are a variety of professional issues that must be considered in the reissuance of opinions that affect the amount of fees charged for the predecessor auditor to re-issue its opinion on prior year financial statements, including: the unleveraged nature of the work, which requires more partner attention; the timing of the required effort; the consideration of events and transactions that have taken place subsequent to the original report issuance; and the content of the current auditor’s representation letter to the predecessor auditor.

In addition, the Committee cites “the challenges associated with having the predecessor auditor transfer its work papers to the successor auditor”[7] as an obstacle to auditor changes. Just as there are a variety of circumstances that affect the amount of fees charged, there are many circumstances that affect the willingness of the predecessor auditor to provide access to its workpapers, including information related to pending litigation, unpaid fees from the client, and ongoing regulatory inquiries and investigations, among others. We would suggest that if the Committee does not eliminate this addition to its commentary, it take a more balanced approach in presenting support for this recommendation. This should include acknowledgement of the many professional requirements that impact the process of changing auditors, large or small.

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If you have any questions or would like to discuss these issues further, please do not hesitate to contact Robert Kueppers at (212) 492-4241. We thank you for your consideration of these comments.

Very truly yours,

/s/ Deloitte LLP

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[4] July 22nd Report at VI:4.
[5] Record of Proceedings (June 3, 2008) (Questions for the Record of Kurt N. Schacht, Managing Director, Centre for Financial Markets Integrity, CFA Institute (June 30, 2008)), *available at* http://www.treas.gov/offices/domestic-finance/acap/agendas/QFRs-6-3-08.pdf.
[6] S*ee Supra* Note 13.
[7] July 22nd Report at VI:5.