



Via Email

May 10, 2012

Office of the Secretary  
PCAOB  
1666 K Street, NW  
Washington, DC 20006-2803

**Re: Proposed Auditing Standard, Related Parties, Amendments to Certain PCAOB Auditing Standards Regarding Significant Unusual Transactions, and Other Amendments to PCAOB Auditing Standards (PCAOB Rulemaking Docket Matter No. 038) (Related Parties Proposal)**

Dear Office of the Secretary:

I am writing on behalf of the Council of Institutional Investors (Council), a nonprofit association of public, corporate, and union employee benefit plans with combined assets of over \$3 trillion. Member funds are major shareowners with a duty to protect the retirement assets of millions of American workers.<sup>1</sup> The Council appreciates the opportunity to provide input to the Public Company Accounting Oversight Board's (Board) Related Parties Proposal.<sup>2</sup>

The Council supports the objective of the Related Parties Proposal to "improve the auditor's evaluation of the identification of, accounting for, and disclosure about related parties and significant unusual transactions."<sup>3</sup> We generally agree with the Board that improvements in this area are "important to the protection of the interests of investors and to the preparation of informative, accurate, and independent audit reports."<sup>4</sup>

---

<sup>1</sup> For more information about the Council of Institutional Investors (Council) and its members, please visit the Council's website at <http://www.cii.org/about>.

<sup>2</sup> Proposed Auditing Standard, *Related Parties*, Amendments to Certain PCAOB Auditing Standards Regarding Significant Unusual Transactions, and Other Amendments to PCAOB Auditing Standards, PCAOB Release No. 2012-001, PCAOB Rulemaking Docket Matter No. 038 (Feb. 28, 2012), [http://pcaobus.org/Rules/Rulemaking/Docket038/Release\\_2012-001\\_Related\\_Parties.pdf](http://pcaobus.org/Rules/Rulemaking/Docket038/Release_2012-001_Related_Parties.pdf) [hereinafter Related Parties Proposal].

<sup>3</sup> James R. Doty, Chairman, PCAOB, Proposed Auditing Standard on Related Parties and Proposed Amendments on Significant and Unusual Transactions 1 (Feb. 28, 2012), [http://pcaobus.org/News/Speech/Pages/02282012\\_DotyStandard.aspx](http://pcaobus.org/News/Speech/Pages/02282012_DotyStandard.aspx).

<sup>4</sup> Related Parties Proposal, *supra* note 2, at 2.

We are particularly supportive of the proposed enhancements to the existing requirements of Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement*. As we understand it, those proposed enhancements would require the auditor to perform certain procedures, including the reading of compensation contracts, necessary to obtain an understanding of the company's executive compensation. We generally agree with the Board that those proposed enhancements would likely have a number of important benefits, including:

- “[A]ssist[ing] the auditor in understanding whether such compensation arrangements affect the assessment of the risks of material misstatement,”<sup>5</sup> and
- “[A]ssist[ing] the auditor in identifying fraud risks.”<sup>6</sup>

We generally believe the proposed enhancements are aligned with the Council's membership approved policies. Those policies have long recognized that executive compensation is a critical aspect of a company's governance.<sup>7</sup> That view was reaffirmed in connection with the financial crisis.<sup>8</sup> In evaluating the reasons behind the financial crisis, and proposing potential reforms, the Investors Working Group concluded:

Poorly structured pay plans that rewarded short-term but unsustainable performance encouraged CEOs to pursue risky strategies that hobbled one financial institution after another and tarnished the credibility of U.S. financial markets.<sup>9</sup>

---

<sup>5</sup> *Id.* at A4-42. We are reminded that in 2008 the Department of Treasury's Advisory Committee on the Auditing Profession directed two important recommendations to the Public Company Accounting Oversight Board relating to fraud detection and that neither of those recommendations have been adopted. Department of Treasury, Advisory Committee on the Auditing Profession, Final Report VII:1 & VII:13 (Oct. 6, 2008), <http://www.treasury.gov/about/organizational-structure/offices/Documents/final-report.pdf>. We continue to generally support the adoption of those recommendations.

<sup>6</sup> Related Parties Proposal, *supra* note 2, at A4-43.

<sup>7</sup> The Council of Institutional Investors, Corporate Governance Policies § 5.1 Introduction (Last updated Dec. 21, 2011), [http://www.cii.org/UserFiles/file/CII%20Corp%20Gov%20Policies%20Full%20and%20Current%2012-21-11%20FINAL%20\(2\).pdf](http://www.cii.org/UserFiles/file/CII%20Corp%20Gov%20Policies%20Full%20and%20Current%2012-21-11%20FINAL%20(2).pdf) (“The Council believes that executive compensation is a critical and visible aspect of a company's governance.”).

<sup>8</sup> See, e.g., A Report by the Investors' Working Group, U.S. Financial Regulatory Reform: The Investors' Perspective 22 (July 2009), [http://www.cii.org/UserFiles/file/resource%20center/investment%20issues/Investors%27%20Working%20Group%20Report%20\(July%202009\).pdf](http://www.cii.org/UserFiles/file/resource%20center/investment%20issues/Investors%27%20Working%20Group%20Report%20(July%202009).pdf).

<sup>9</sup> *Id.*

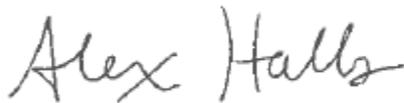
May 10, 2012

Page 3 of 3

It makes sense to us that requiring auditor's to perform additional procedures to obtain a better understanding of perhaps the most critical and visible aspect of a company's governance would, as the Board has concluded, "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 . . . ." <sup>10</sup> The result should be higher quality audits that better assist investors in making informed investment decisions, and that improve public confidence in the financial markets. <sup>11</sup> We, therefore, strongly support this provision of the Related Parties Proposal.

The Council again appreciates the opportunity to comment on the Related Parties Proposal. We thank you for considering our views. Please feel free to contact me at 202.261.7088 or [alex@cii.org](mailto:alex@cii.org), or the Council's General Counsel Jeff Mahoney at 202.261.7081 or [jeff@cii.org](mailto:jeff@cii.org) with any questions.

Sincerely,

A handwritten signature in cursive script that reads "Alex Halls".

Alex Halls

---

<sup>10</sup> Related Parties Proposal, *supra* note 2, at A4-44.

<sup>11</sup> See generally Council of Institutional Investors, **Statement on Financial Gatekeepers** 1 (Apr. 13, 2010), <http://www.cii.org/UserFiles/file/Statement%20on%20Financial%20Gatekeepers.pdf> (noting that auditors, as financial gatekeepers, provide investors with information they need to make informed decisions, and have an impact on public confidence in the markets).