

The FTA and METRO have completed a SFEIS for the Southeast Corridor Fixed Guideway Transit Project (Southeast Corridor Project). The Southeast Corridor Project will start in downtown Houston; connect to the universities area including Texas Southern University, University of Houston, and the Palm Center; and end at a terminus on Griggs Road and Beekman Road. The light rail will operate in portions of the alignment on both restricted street lanes and an exclusive bi-directional trackway. For the Southeast Corridor Project, METRO will also construct a vehicle storage facility, ten passenger stations, and a traction power electrical system. *Final agency actions:* ROD signed on July 16, 2008; Section 4(f) de minimis impact finding; Section 106 Memorandum of Agreement signed on June 4, 2008; Project-level Air Conformity determination. *Supporting documentation:* Southeast Corridor Fixed Guideway Supplemental Final Environmental Impact Statement (SFEIS) signed on April 25, 2008.

3. *Project name and location:* Portland Streetcar Loop Project, Portland Oregon. *Project sponsor:* Tri-County Metropolitan Transportation District (TriMet). *Project description:* The project involves the construction of 3.3 miles of double track rail lines in existing streets and public rights-of-way from NW 10th Avenue and Lovejoy Street in the Pearl District of northwest Portland to the Oregon Museum of Science and Industry in southeast Portland. TriMet plans to construct 18 new station pairs with designs similar to those along the existing Portland Streetcar alignment. The project also includes the purchase of 10 streetcars, expansion of the existing streetcar operations and maintenance facility, roadway improvements, and elimination of some bus line service. *Final agency actions:* FONSI signed on July 2, 2008; Section 106 Finding of No Adverse Effect; Project-level Air Conformity determination; Section 4(f) de minimis impact finding. *Supporting documentation:* Environmental Assessment on the Portland Streetcar Loop Project issued on February 8, 2008.

4. *Project name and location:* Central Florida Commuter Rail Transit Project, Orlando, Florida. *Project sponsor:* Florida Department of Transportation (FDOT). *Project description:* FDOT is proposing to operate a commuter rail project on approximately 61 miles of existing freight rail tracks that traverse Orange, Seminole, Volusia, and Osceola counties in the greater metropolitan area of Orlando, Florida. The project will involve the construction of 17 stations

and a new vehicle storage and maintenance facility. On April 27, 2007, FTA issued a FONSI on the Central Florida Commuter Rail Transit (CFCRT) North/South Corridor project stating that the project would not have a significant impact on the environment. Since issuing the FONSI, FDOT made several changes to stations on the CFCRT project and these changes were reviewed in a Supplemental EA approved on May 8, 2008. The final agency actions announced in this notice only concern these project changes which are of limited scope and do not warrant reconsideration of the entire project. *Final agency actions:* FONSI signed on July 22, 2008; Section 106 Finding of No Effect on Historic Properties dated June 20, 2008; Section 4(f) finding. *Supporting documentation:* Supplemental Environmental Assessment on the Central Florida Commuter Rail Transit North/South Corridor Project approved on May 8, 2008.

Issued on: July 24, 2008.

Susan Borinsky,

Associate Administrator for Planning and Environment, Washington, DC.

[FR Doc. E8-17482 Filed 7-29-08; 8:45 am]

BILLING CODE 4910-57-P

DEPARTMENT OF TRANSPORTATION

Surface Transportation Board

[STB Ex Parte No. 670 (Sub-No. 1)]

Notice of Rail Energy Transportation Advisory Committee Meeting

AGENCY: Surface Transportation Board.

ACTION: Notice of Rail Energy Transportation Advisory Committee meeting.

SUMMARY: Notice is hereby given of a meeting of the Rail Energy Transportation Advisory Committee (RETAC), pursuant to section 10(a)(2) of the Federal Advisory Committee Act, Public Law 92-463, as amended (5 U.S.C., App. 2).

DATES: The meeting will be held on Wednesday, September 17, 2008, beginning at 9 a.m.

ADDRESSES: The meeting will be held in the Surface Transportation Board's hearing room on the 1st floor of the agency's headquarters at Patriot's Plaza, 395 E Street, SW., Washington, DC 20423-0001.

FOR FURTHER INFORMATION CONTACT: Scott M. Zimmerman at 202-245-0202. [Assistance for the hearing impaired is available through the Federal

Information Relay Service (FIRS) at: (800) 877-8339].

SUPPLEMENTARY INFORMATION: RETAC arose from a proceeding instituted by the Board, in *Establishment of a Rail Energy Transportation Advisory Committee*, STB Ex Parte No. 670. RETAC was formed to provide advice and guidance to the Board, and to serve as a forum for discussion of emerging issues regarding the transportation by rail of energy resources, particularly, but not necessarily limited to, coal, ethanol, and other biofuels. The purpose of this meeting is to continue discussions regarding issues such as rail performance, capacity constraints, infrastructure planning and development, and effective coordination among suppliers, carriers, and users of energy resources.

The meeting, which is open to the public, will be conducted pursuant to RETAC's charter and Board procedures. Further communications about this meeting may be announced through the Board's Web site at <http://www.stb.gov>.

This action will not significantly affect either the quality of the human environment or the conservation of energy resources.

Authority: 49 U.S.C. 721, 49 U.S.C. 11101; 49 U.S.C. 11121.

Decided: July 24, 2008.

By the Board, Anne K. Quinlan, Acting Secretary.

Anne K. Quinlan,

Acting Secretary.

[FR Doc. E8-17375 Filed 7-29-08; 8:45 am]

BILLING CODE 4915-01-P

DEPARTMENT OF THE TREASURY

Second Draft Report of the Advisory Committee on the Auditing Profession

AGENCY: Office of the Undersecretary for Domestic Finance, Treasury.

ACTION: Notice; request for comments.

SUMMARY: The Advisory Committee on the Auditing Profession is publishing a Second Draft Report and soliciting public comment.

DATES: Comments should be received on or before August 26, 2008.

ADDRESSES: Comments may be submitted to the Advisory Committee by any of the following methods:

Electronic Comments

- Use the Department's Internet submission form (<http://www.treas.gov/offices/domestic-finance/acap/comments>); or

Paper Comments

• Send paper comments in triplicate to Advisory Committee on the Auditing Profession, Office of Financial Institutions Policy, Room 1418, Department of the Treasury, 1500 Pennsylvania Avenue, NW., Washington, DC 20220.

In general, the Department will post all comments on its Web site (<http://www.treas.gov/offices/domestic-finance/acap/comments>) without change, including any business or personal information provided such as names, addresses, e-mail addresses, or telephone numbers. The Department will also make such comments available for public inspection and copying in the Department's Library, Room 1428, Main Department Building, 1500 Pennsylvania Avenue, NW., Washington, DC 20220, on official business days between the hours of 10 a.m. and 5 p.m. Eastern Time. You can make an appointment to inspect comments by telephoning (202) 622-0990. All comments, including attachments and other supporting materials, received are part of the public record and subject to public disclosure. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT:

Kristen E. Jaconi, Senior Policy Advisor to the Under Secretary for Domestic Finance, Department of the Treasury, Main Department Building, 1500 Pennsylvania Avenue, NW., Washington, DC 20220, at (202) 927-6618.

SUPPLEMENTARY INFORMATION: At the request of the two Co-Chairs of the Department of the Treasury's Advisory Committee on the Auditing Profession, the Department is publishing this notice soliciting public comment on the Advisory Committee's Second Draft Report. The text of the Second Draft Report is found in the appendix to this notice and may be found on the Web page of the Advisory Committee at <http://www.treas.gov/offices/domestic-finance/acap/index.shtml>. The appendices to the Second Draft Report are not included in this notice, but may be found on the Web page of the Advisory Committee at <http://www.treas.gov/offices/domestic-finance/acap/index.shtml>. The Second Draft Report contains the Advisory Committee's developed proposals on improving the sustainability of a strong and vibrant public company auditing profession. All interested parties are invited to submit their comments in the manner described above.

Dated: July 25, 2008.

Taiya Smith,
Executive Secretary.

Appendix: Advisory Committee on the Auditing Profession

Second Draft Report—July 22, 2008

The Department of the Treasury

Second Draft Report of the Advisory Committee on the Auditing Profession to the U.S. Department of the Treasury

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Transmittal Letter**I. Advisory Committee on the Auditing Profession**

[September 2008]

The Honorable Hank M. Paulson, Jr.,
Secretary,
U.S. Department of the Treasury,
1500 Pennsylvania Avenue, NW.,
Washington, DC 20220.
Dear Secretary Paulson:

On behalf of the Department's Advisory Committee on the Auditing Profession, we are pleased to submit our Final Report.

[Contents of letter to be included in Final Report]

Respectfully Submitted on behalf of the Committee,

Arthur Levitt, Jr.
Committee Co-Chair

Donald T. Nicolaisen
Committee Co-Chair
Enclosure

CHAPTER I: COMMITTEE HISTORY

On November 20, 2006, the Secretary of the Treasury, Henry M. Paulson, Jr., delivered a speech on the competitiveness of the U.S. capital markets, highlighting the need for a sustainable auditing profession.¹ In March 2007, Secretary Paulson hosted a conference at Georgetown University with investors, current and former policymakers, and market participants to discuss issues impacting the competitiveness of the U.S. capital markets, including the sustainability of the auditing profession.²

On May 17, 2007, Secretary Paulson announced the Department of the Treasury's (the "Department's") intent to establish the Advisory Committee on the Auditing Profession (the "Committee") to consider and develop recommendations relating to the sustainability of the auditing profession.³ At the same time, Secretary Paulson announced that he had asked Arthur Levitt, Jr. and Donald T. Nicolaisen to serve as Co-Chairs of the Committee. The Department published the official notice of establishment and requested nominations for membership on the Committee in the **Federal Register** on June 18, 2007.⁴ Secretary Paulson announced the Committee's membership on October 2, 2007, with members drawn from a wide range of professions, backgrounds, and experiences.⁵ The Department filed the

¹ Treasury Secretary Henry M. Paulson, Jr., Remarks on the Competitiveness of U.S. Capital Markets at the Economic Club of New York (Nov. 20, 2006), in Press Release No. HP-174, U.S. Dep't of Treas. (Nov. 20, 2006) (included as Appendix C).

² Treasury Secretary Henry M. Paulson, Jr., Opening Remarks at Treasury's Capital Markets Competitiveness Conference at Georgetown University (Mar. 13, 2007), in Press Release No. HP-306, U.S. Dep't of Treas. (Mar. 13, 2007) (included as Appendix D).

³ Press Release, U.S. Dep't of Treas., Paulson Announces First Stage of Capital Markets Action Plan (May 17, 2007) (included as Appendix E); Press Release, U.S. Dep't of Treas., Paulson: Financial Reporting Vital to U.S. Market Integrity, Strong Economy (May 17, 2008) (included as Appendix F).

⁴ Notice of Intent to Establish; Request for Nominations, 72 FR 33560 (U.S. Dep't of Treas. June 18, 2007) (included as Appendix A).

⁵ Press Release, U.S. Dep't of Treas., Paulson Announces Auditing Committee Members to Make

Committee's Charter with the Senate Committee on Banking, Housing, and Urban Affairs, the Senate Committee on Finance, the House Committee on Financial Services, and the House Committee on Ways and Means on July 3, 2007.⁶

Committee Activities

The Committee held its initial meeting on October 15, 2007 in Washington, D.C.⁷ Then Under Secretary for Domestic Finance Robert K. Steel welcomed the Committee members and provided introductory remarks.⁸ Also on October 15, 2007, the Committee adopted its by-laws⁹ and considered a Working Discussion Outline to be published for public comment.¹⁰ The Working Discussion Outline identified in general terms issues for the Committee's consideration. A Working Bibliography, updated intermittently throughout the course of the Committee's deliberations, provided the members with articles, reports, studies, and other written materials relating to the auditing profession.¹¹ All full Committee meetings were open to the public and conducted in accordance with the requirements of the Federal Advisory Committee Act.¹² The meetings of the full Committee were also Web or audio cast over the Internet.

The Committee held its second meeting on December 3, 2007 in Washington, DC. The agenda for this

Recommendations for a More Sustainable, Transparent Industry (Oct. 2, 2007) (included as Appendix G). This press release describes the diverse backgrounds of the Committee members. For a list of Members, Observers, and Staff, see Appendix K.

⁶ See Committee Charter (included as Appendix B).

⁷ The Record of Proceedings of this and subsequent meetings of the Committee are available on the Department's Web site at <http://www.treas.gov/offices/domestic-finance/acap/press.shtml>. See Record of Proceedings, Meeting of the Committee (Oct. 15, 2007, Dec. 3, 2007, Feb. 4, 2008, Mar. 13, 2008, Apr. 1, 2008, May 5, 2008, June 3, 2008, and [____]) [hereinafter Record of Proceedings (with appropriate date)] (on file in the Department's Library, Room 1428), available at <http://www.treas.gov/offices/domestic-finance/acap/press.shtml>.

⁸ Under Secretary for Domestic Finance Robert K. Steel, Welcome and Introductory Remarks Before the Initial Meeting of the Treasury Department's Advisory Committee on the Auditing Profession (Oct. 15, 2007), in Press Release No. HP-610, U.S. Dep't of Treas. (Oct. 15, 2007) (included as Appendix H).

⁹ The Committee By-Laws are included as Appendix I.

¹⁰ The Working Discussion Outline is included as Appendix L.

¹¹ The Working Bibliography is included as Appendix M. The Working Bibliography was subsequently updated in December 2007, February 2008, and July 2008.

¹² 5 U.S.C. ____ App. 2 *et seq.*

meeting consisted of hearing oral statements from witnesses and considering written submissions that those witnesses had filed with the Committee. The oral statements and written submissions focused on the issues impacting the sustainability of the auditing profession, including issues mentioned in the Working Discussion Outline. Nineteen witnesses testified at this meeting.¹³ The Committee held a subsequent meeting on February 4, 2008 in Los Angeles, California at the University of Southern California. The agenda for this meeting consisted of hearing oral statements from witnesses and considering written submissions that those witnesses had filed with the Committee. The oral statements and written submissions focused on the issues impacting the sustainability of the auditing profession, including issues mentioned in the Working Discussion Outline. Seventeen witnesses testified at this meeting.¹⁴ The Committee held additional meetings on March 13, 2008, April 1, 2008, May 5, 2008, June 3, 2008, and [____]. All were face-to-face meetings held at the Department in Washington, DC, except for February 4, 2008, which was held in Los Angeles, California, and the meetings on April 1, 2008, and [____], which were telephonic meetings. No witnesses testified at these additional meetings, except for the June 3, 2008 meeting. The agenda for the June 3, 2008 meeting consisted of hearing oral statements from witnesses and considering written submissions that those witnesses had filed with the Committee. The oral statements and written submissions focused on the issues mentioned in the Draft Report and Draft Report Addendum. Twenty-one witnesses testified at this meeting.¹⁵

The Committee, through the Department, published [____] releases in the **Federal Register** formally seeking public comment on issues under consideration. On October 31, 2007, the Committee published a release seeking comment on the Working Discussion Outline,¹⁶ in response to which the Committee received seventeen comment letters. On May 15, 2008 and on June 12, 2008, the Committee published releases seeking comment on the Draft Report¹⁷

¹³ Appendix J contains a list of witnesses who testified before the Committee.

¹⁴ Appendix J contains a list of witnesses who testified before the Committee.

¹⁵ Appendix J contains a list of witnesses who testified before the Committee.

¹⁶ Request for Comments, 72 FR 61709 (U.S. Dep't of Treas. Oct. 31, 2007).

¹⁷ Request for Comments, 73 FR 28190 (U.S. Dep't of Treas. May 15, 2008).

and Draft Report Addendum,¹⁸ respectively, in response to which the Committee received [____] comment letters. In addition, the Department announced each meeting of the Committee in the **Federal Register**, and in each announcement notice included an invitation to submit written statements to be considered in connection with the meeting.¹⁹ In response to these meeting notices, the Committee received [____] written submissions. In total, the Committee received [____] written submissions in response to **Federal Register** releases.²⁰ All of the submissions made to the Committee will be archived and available to the public through the Department's Library.

In addition to work carried out by the full Committee, fact finding and deliberations also took place within three Subcommittees appointed by the Co-Chairs. The Subcommittees were organized according to their principal areas of focus: Human Capital, Firm Structure and Finances, and Concentration and Competition.²¹ Each of the Subcommittees prepared recommendations for consideration by the full Committee.

III. Background

[Contents of Background to be included in subsequent drafts of this Report.]

IV. Human Capital

The Committee devoted considerable time and effort surveying the human capital issues impacting the auditing profession, including education, licensing, recruitment, retention, and training of accounting and auditing professionals. The charter of the Committee charged its members with developing recommendations relating to the sustainability of the public company

¹⁸ Request for Comments, 73 FR 33487 (U.S. Dep't of Treas. June 12, 2008).

¹⁹ Notice of Meeting, 72 FR 55272 (U.S. Dep't of Treas. Sept. 28, 2007); Notice of Meeting, 72 FR 64283 (U.S. Dep't of Treas. Nov. 15, 2007); Notice of Meeting, 73 FR 2981 (U.S. Dep't of Treas. Jan. 16, 2008); Notice of Meeting, 73 FR 10511 (U.S. Dep't of Treas. Feb. 27, 2008); Notice of Meeting, 73 FR 13070 (U.S. Dep't of Treas. Mar. 11, 2008); Notice of Meeting, 73 FR 21016 (U.S. Dep't of Treas. Apr. 17, 2008); Notice of Meeting, FR 28208 (U.S. Dep't of Treas. May 15, 2008); Notice of Meeting, FR 39088 (U.S. Dep't of Treas. July 8, 2008).

²⁰ All of the written submissions made to the Committee are available in the Department's Library, Room 1428 and on the Department's Committee's Web page at <http://www.treas.gov/offices/domestic-finance/acap/press.shtml>. To avoid duplicative material in footnotes, citations to the written submissions made to the Committee in this Final Report do not reference the Department's Library, Room 1428 or repeat the file number.

²¹ For a list of members and their Subcommittee assignments, see Appendix K.

auditing profession. Likewise, the Committee directs the following recommendations and related commentary to those practicing public company auditing. However, the Committee recognizes that several of its recommendations regarding human capital matters would have impact beyond the public company auditing profession, impacting the accounting profession as a whole. The Committee views the accelerating pace of change in the global corporate environment and capital markets and the increasing complexity of business transactions and financial reporting as among the most significant challenges facing the profession as well as financial statement issuers and investors. These are directly impacted by human capital issues. To ensure its viability and resilience and its ability to meet the needs of investors, the public company auditing profession needs to continue to attract and develop professionals at all levels who are prepared to perform high quality audits in this dynamic environment. It is essential that these professionals continue to be educated and trained to review, judge, and question all accounting and auditing matters with skepticism and a critical perspective. The recommendations presented below reflect these needs.

After receiving testimony from witnesses and from comment letters, the Committee identified specific areas where the Committee believed it could develop recommendations to be implemented in the relatively short term to enhance the sustainability of the auditing profession. These specific areas include accounting curricula, accounting faculty, minority representation and retention, and development and maintenance of human capital data. The Committee has also developed a recommendation to study the possible future of higher accounting education's institutional structure.

The Committee recommends that regulators, the auditing profession, educators, educational institutions, accrediting agencies, and other bodies, as applicable, effectuate the following:

Recommendation 1. Implement market-driven, dynamic curricula and content for accounting students that continuously evolve to meet the needs of the auditing profession and help prepare new entrants to the profession to perform high quality audits.

The Committee considered the views of all witnesses who provided input regarding accounting curricula at

educational institutions.²² The Committee believes that the accounting curricula in higher education are critical to ensuring that individuals have the necessary knowledge, mindset, skills, and abilities to perform quality public company audits. In order to graduate from an educational institution with an accounting degree, students must have completed a certain number of hours in accounting and business courses. Accounting curricula typically include courses in auditing, financial accounting, cost accounting, and U.S. federal income taxation. Business curricula typically include courses in ethics, information systems and controls, finance, economics, management, marketing, oral and written communication, statistics, and U.S. business law.²³ Since the 1950s, several private sector groups have studied and recommended changes to the accounting curricula,²⁴ but

²² See, e.g., Record of Proceedings (Dec. 3, 2007) (Written Submission of Joseph V. Carcello, Director of Research, Corporate Governance, University of Tennessee, Knoxville, 8), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Carcello120307.pdf> (noting the market's expectations that university accounting curricula will expose students to recent financial reporting developments, such as international financial reporting standards and eXtensible Business Reporting Language); Record of Proceedings (Feb. 4, 2008) (Written Submission of Cynthia Fornelli, Executive Director, Center for Audit Quality, 3), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Fornelli020408.pdf> (stating the need to "[d]edicate funds and people to work with accounting professors to ensure that the curriculum is keeping pace with developments in business transactions, international economics and financial reporting" and specifying the need to focus on ethical standards and international accounting and auditing standards); Record of Proceedings (Dec. 3, 2007) (Written Submission of Dennis Nally, Chairman and Senior Partner, PricewaterhouseCoopers LLP, 4), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Nally120307.pdf> (stating the need to "[m]odernize and enhance the university accounting curriculum, which should include consideration of other global curriculum models to increase knowledge of International Financial Reporting Standards (IFRS), finance and economics, and process controls").

²³ Record of Proceedings (Feb. 4, 2008) (Written Submission of Phillip M.J. Reckers, Professor of Accountancy, Arizona State University, 13), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Reckers020408.pdf> (commenting that business students typically take two sophomore-level introductory accounting classes and accounting majors take six additional accounting courses in their final two years of schooling).

²⁴ See e.g., Franklin Pierson, et al., *The Education of American Businessmen* (1959) (noting that the main goal of a business education should be the development of an individual with broad training in both the humanities and principles of business); Robert A. Gordon and James E. Howell, *Higher Education for Business* (1959) (suggesting that accounting curriculum abandon its emphasis on financial accounting and auditing while emphasizing humanities); Robert H. Roy and James

notwithstanding these pleas for reform, curricula are characteristically slow to change.²⁵

In this regard, the Committee makes the following recommendations:

(a) Regularly update the accounting certification examinations to reflect changes in the accounting profession, its relevant professional and ethical standards, and the skills and knowledge required to serve increasingly global capital markets.

Accounting and auditing professionals commonly complete the requirements of professional examinations in order to comply with legal or professional association requirements. To become licensed at the state level as a certified public

H. MacNeill, *Horizons for a Profession* (1967) (emphasizing the importance of a humanities background for accountants and recommending accounting graduate study); American Institute of Certified Public Accountants, Committee on Education and Experience Requirements for CPAs, Report of the Committee on Education and Experience Requirements for CPAs (Mar. 1969) (recommending, among other things, a five-year education requirement to be adopted by states by 1975); American Institute of Certified Public Accountants, Education Requirements for Entry into the Accounting Profession: A Statement of AICPA Policies (May 1978) (preferring a 150 semester-hour education requirement rather than a five-year education requirement to acquire the common body of knowledge and sit for the CPA examination); American Accounting Association, Committee on the Future Structure, Content, and Scope of Accounting Education, *Future Accounting Education: Preparing for the Expanding Profession*, 1 *Issues in Accounting Education*, No. 1, 168–95 (Spring 1986) (examining accounting education and accounting practice since 1925 and concluding that, among other things, the current state of accounting education is inadequate to meet the dynamic needs of the profession and accounting education must be reassessed to meet these needs); American Institute of Certified Public Accountants, Education Requirements for Entry into the Accounting Profession: A Statement of AICPA Policies, 2nd Ed., Revised (Feb. 1988) (reaffirming the 150 semester-hour requirement); Arthur Andersen & Co., Arthur Young, Coopers & Lybrand, Deloitte Haskins & Sells, Ernst & Whinney, Peat Marwick Main & Co., Price Waterhouse, and Touche Ross, *Perspectives on Education: Capabilities for Success in the Accounting Profession* (1989), available at <http://aaahq.org/aecc/big8/cover.htm> (stating that the chief executive officers of the eight largest public accounting firms believe that graduates entering public accounting need to have greater interpersonal, communication, and thinking skills as well as greater business knowledge and that the accounting curriculum must be a dynamic experience); and Accounting Education Change Commission, *Objectives of Education for Accountants: Position Statement Number One*, 6 *Issues in Accounting Education*, No. 2, 307–12 (Fall 1990) (describing the education objectives for accountants in an environment where accounting education has not kept pace with the changing demands upon the accounting profession).

²⁵ Record of Proceedings (Dec. 3, 2007) (Written Submission of Ira Solomon, R.C. Evans Distinguished Professor, and Head, Department of Accountancy, University of Illinois, 14–15), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Solomon120307.pdf> (lamenting the slow pace of change in accounting curricula and education).

accountant, an individual must, among other things, pass the Uniform CPA Examination. Professional examinations, such as the Uniform CPA Examination, influence the content of the technical, ethical, and professional materials comprising the accounting curricula.²⁶

The Committee believes that evolution of professional examination content serves as an important catalyst for curricular changes to reflect the dynamism and complexity of auditing public companies in global capital markets. The American Institute of Certified Public Accountants (AICPA) already regularly analyzes and updates its examination content, through practice content analysis and in conjunction with the AICPA Board of Examiners, which comprises members from the profession and state boards of accountancy. The Committee recommends that such changes remain a focus to ensure that both the 150 semester hour curriculum²⁷ as well as examination content reflect in a timely

manner important ongoing market developments and investor needs, such as the increasing use of international financial reporting standards (IFRS),²⁸ expanded fair value measurement and reporting, increasingly complex transactions, new Public Company Accounting Oversight Board (PCAOB) auditing and professional standards,²⁹ risk-based business judgment, and technological innovations in financial reporting.

Moreover, the Committee believes that professional³⁰ and ethical standards,³¹ fraud examination and forensic auditing, financial risk management, and valuation, and subject matter relating to their application, are an essential component of the accounting and auditing curricula and accordingly should be reflected in the professional examinations and throughout business and accounting coursework.³²

²⁶ Gary Sundem, *The Accounting Education Change Commission: Its History and Impact* Chapter 6 (1999), available at <http://aaahq.org/AECC/history/index.htm> ("[T]he CPA examination has certainly had a major influence on the accounting curriculum and on other aspects of accounting programs.")

²⁷ See, e.g., *Record of Proceedings* (Written Submission of Jean C. Bedard, Timothy B. Harbert Professor of Accounting, Department of Accountancy, Bentley College, 1), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Bedard060308.pdf> (observing that using the CPA Examination as a catalyst for curricula change will only be effective if the CPA Examination is written assuming completion of 150 hours); *Record of Proceedings* (June 3, 2008) (Questions for the Record of Joseph V. Carcello, Chair, AAA Task Force to Monitor the Activities of the Treasury ACAP, Professor and Director of Research—Corporate Governance Center, University of Tennessee, Jean C. Bedard, Professor of Accountancy, Bentley College, and Dana R. Hermanson, Chair of Private Enterprise and Professor of Accounting, Kennesaw State University, 2 (June 20, 2008)), available at <http://www.treas.gov/offices/domestic-finance/acap/agendas/QFRs-6-3-08.pdf> (noting that recent developments suggest a trend away from requiring 150 hours to sit for the CPA examination since eighteen states allow candidates to sit for the exam after 120 hours); Edward P. Howard, Senior Counsel, and Julianne D'Angelo Fellmeth, Administrative Director, Center for Public Interest Law, *Comment Letter Regarding Draft Report and Draft Report Addendum 2-4* (June 13, 2008), available at http://comments.treas.gov/_files/ACAP_Draft_Report_Comments.pdf (providing background on the issue of requiring 150-hours for licensure while allowing 120-hours to sit for the CPA Examination in California); *Record of Proceedings* (June 3, 2008) (Oral Remarks of Anne M. Mulcahy, Chairman and Chief Executive Officer, Xerox Corporation, and Alan L. Beller, Partner, Cleary Gottlieb Steen & Hamilton LLP, 70-71, 77), available at <http://www.treas.gov/offices/domestic-finance/acap/agendas/minutes-06-03-08.pdf> (noting the tension between updating the curricula in order to keep current with the changing environment and fitting these changes into a four-year program).

²⁸ Samuel K. Cotterell, CPA, Chair, NASBA, and David A. Costello, CPA, President and CEO, NASBA, *Comment Letter Regarding Draft Report and Draft Report Addendum 1* (June 29, 2008), available at http://comments.treas.gov/_files/June2908LetterheadTreasuryAdvisoryCommitteeontheAuditingProfession.pdf (agreeing that IFRS should be reflected in the CPA examination); Arnold C. Hanish, Chair, Committee on Corporate Reporting, Financial Executives International, *Comment Letter Regarding Draft Report and Draft Report Addendum 2* (July 3, 2008), available at http://comments.treas.gov/_files/FEICCRTreasuryACAPCommentLetterFiled73080.pdf (suggesting a greater emphasis of IFRS in the accounting curriculum).

²⁹ See e.g., *An Audit of Internal Control Over Financial Reporting that is Integrated with an Audit of Financial Statements*, Auditing Standard No. 5 (Pub. Company Accounting Oversight Bd. 2007).

³⁰ See PCAOB Standards and Related Rules, available at http://www.pcaobus.org/Standards/Standards_and_Related_Rules/index.aspx.

³¹ See PCAOB Interim Ethics Standards, available at http://www.pcaobus.org/Standards/Interim_Standards/Ethics/index.aspx.

³² See, e.g., Samuel K. Cotterell, CPA, Chair, NASBA, and David A. Costello, CPA, President and CEO, NASBA, *Comment Letter Regarding Draft Report and Draft Report Addendum 1* (June 29, 2008), available at http://comments.treas.gov/_files/June2908LetterheadTreasuryAdvisoryCommitteeontheAuditingProfession.pdf (agreeing that ethics should be included in the accounting curriculum); Deloitte LLP, *Comment Letter Regarding Draft Report and Draft Report Addendum 9* (June 27, 2008), available at http://comments.treas.gov/_files/DeloitteLLPCommentLetter.pdf (recommending that the Committee state that the following courses should be included in the curricula: ethics, fraud examination and forensic auditing, problem solving, finance, negotiation and communication skills, financial risk management, global business, taxation, and valuation); *Record of Proceedings* (Written Submission of Anne M. Lang, Chief Human Resources Officer, Grant Thornton LLP, 3), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Lang060308.pdf> (asking the Committee to specifically cite the need for curricula that teach specialized knowledge, such as risk management, computational finance, valuation theory, and sophisticated modeling techniques).

Finally, the Committee recommends that the market developments outlined in this section be reflected in professional examination content as soon as practicable, but not later than 2011.³³ In particular, the CPA examination should test a candidate's knowledge consistent with practice needs and the highest contemporary level of education required based on those practice needs. In addition, the Committee recommends that new evolving examination content be widely and promptly communicated to college and university faculty and administrators so that corresponding curricular changes in educational institutions can continually occur on a timely basis.

(b) Reflect real world changes in the business environment more rapidly in teaching materials.

Students are expected to use a variety of sources, such as textbooks and online materials, to learn. Such materials are an important element of higher education. The Committee learned that these commercial materials are generally conservatively managed and follow rather than lead recent market developments.³⁴ Because developing accounting materials involves a significant investment of time and resources, commercial content providers carefully consider the potential risks and rewards before publishing new materials, even where a more prompt response to new developments might be beneficial to students.

The Committee believes that accounting educational materials can contribute to inducing curricular changes that reflect the dynamism and complexity of the global capital markets and that commercial content providers should recognize the importance of capturing recent developments in their published materials. Specifically, the Committee recommends that organizations, such as the AICPA and the American Accounting Association (AAA), meet with commercial content providers and encourage them to update their materials promptly to reflect recent developments such as the increasing use

³³ See, e.g., Samuel K. Cotterell, CPA, Chair, NASBA, and David A. Costello, CPA, President and CEO, NASBA, *Comment Letter Regarding Draft Report and Draft Report Addendum 1* (June 29, 2008), available at http://comments.treas.gov/_files/June2908LetterheadTreasuryAdvisoryCommitteeontheAuditingProfession.pdf (agreeing with the Recommendation to keep the CPA examination current).

³⁴ Subcommittee on Human Capital Record of Proceedings (Jan. 16, 2008) (Oral Remarks of Bruce K. Behn, President, Federation of Schools of Accountancy, and Ergen Professor of Business, Department of Accounting and Information Management, University of Tennessee, Knoxville).

of IFRS, new PCAOB auditing and professional standards, risk-based business judgment, and expanded fair value reporting, as well as technological developments in financial reporting and auditing such as eXtensible Business Reporting Language (XBRL).³⁵

Further, in order to ensure access to such materials and recognizing the benefits of technological innovations,³⁶ the Committee recommends that authoritative bodies and agencies should be encouraged to provide low-cost, affordable access to digitized searchable authoritative literature and materials, such as Financial Accounting Standards Board (FASB) codification and eIFRS, to students and faculty members. Moreover, since the content of professional examinations, such as the Uniform CPA Examination, is based upon research using digitized materials, students need to have access to, among other things, searchable accounting standards.³⁷ The Committee believes that low-cost affordable access to such primary materials would thus enhance student learning and performance and technical research.

(c) Require that schools build into accounting curricula current market developments.

A common theme of our first set of recommendations is that accounting curricula should reflect recent developments, including globalization and evolving market factors. As a further catalyst to curricula development and evolution by educational institutions, the Committee

³⁵ See, e.g., Aram Kostoglian, Eastern Region Attest Practice Leader, and Ernest Baugh, National Director of Professional Standards, Mayer Hoffman McCann P.C., Comment Letter Regarding Draft Report and Draft Report Addendum 1 (June 13, 2008), available at http://comments.treas.gov/_files/MayerHoffmanMcCannCommentLetter.pdf (noting that textbooks lack a thorough discussion of current market developments); PricewaterhouseCoopers LLP, Comment Letter Regarding Draft Report and Draft Report Addendum 4 (June 30, 2008), available at http://comments.treas.gov/_files/PwCCommentLtrTreasCmtDraftandAddendum63008.pdf (noting support for updating teaching materials promptly to reflect recent developments such as the increasing use of IFRS).

³⁶ See Stephanie Woodruff, Chief Revenue Officer, AverQ, Inc., Comment Letter Regarding Draft Report and Draft Report Addendum (June 2, 2008), available at http://comments.treas.gov/index.cfm?FuseAction=Home.ViewPopup&Topic_id=9&FellowType_id=1&Reply_id=95&SuppressLayouts=True (suggesting the use or study of "technology" to address auditing profession challenges).

³⁷ See Record of Proceedings (Feb. 4, 2008) (Written Submission of Phillip M.J. Reckers, Professor of Accountancy, Arizona State University, 14), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Reckers020408.pdf> (affirming the need for student access to digitized searchable accounting and auditing materials).

recommends ongoing attention to responsiveness to recent developments by the bodies that accredit educational institutions. Accrediting agencies review institutions of higher education and their programs and establish that overall resources and strategies are conformed to the mission of the institutions. For example, the Association to Advance Collegiate Schools of Business (AACSB) and the Association of Collegiate Business Schools and Programs (ACBSP) accredit business administration and accounting programs. Since 1919, the AACSB has accredited business administration programs and, since 1980, accounting programs offering undergraduate and graduate degrees. The AACSB has accredited over 450 U.S. business programs and over 150 U.S. accounting programs. Since 1988, the ACBSP has accredited business programs offering associate, baccalaureate, and graduate degrees. As of February 2008, over 400 educational institutions have achieved ACBSP accreditation. The accreditation standards at both accrediting agencies relate to, among other things, curricula, program and faculty resources, and faculty development.

The Committee believes that the accreditation process and appropriate accreditation standards can contribute to curricular changes. In particular, accreditation standards that embody curricular requirements to reflect the dynamism and complexity of the global capital markets and that evolve to keep pace in the future can be helpful in maintaining and advancing the quality of accounting curricula. The AACSB has emphasized in its accreditation standards that accounting curricula should reflect recent market developments. For example, educational institutions must include in their curricula international accounting issues in order to receive AACSB accreditation. The Committee supports the accrediting agencies' efforts to continually develop standards specifically emphasizing the need to update accounting programs.

Recommendation 2. Improve the representation and retention of minorities in the auditing profession so as to enrich the pool of human capital in the profession.

The auditing profession presents challenging and rewarding opportunities for those who pursue a career in auditing and the profession actively recruits talent from all backgrounds.³⁸ Yet, the Committee was

³⁸ The Committee discussed the issue of representation and retention of females in the profession and the Committee found that the

concerned by what it heard from individuals with various backgrounds about minority representation and retention in the auditing profession.³⁹ In

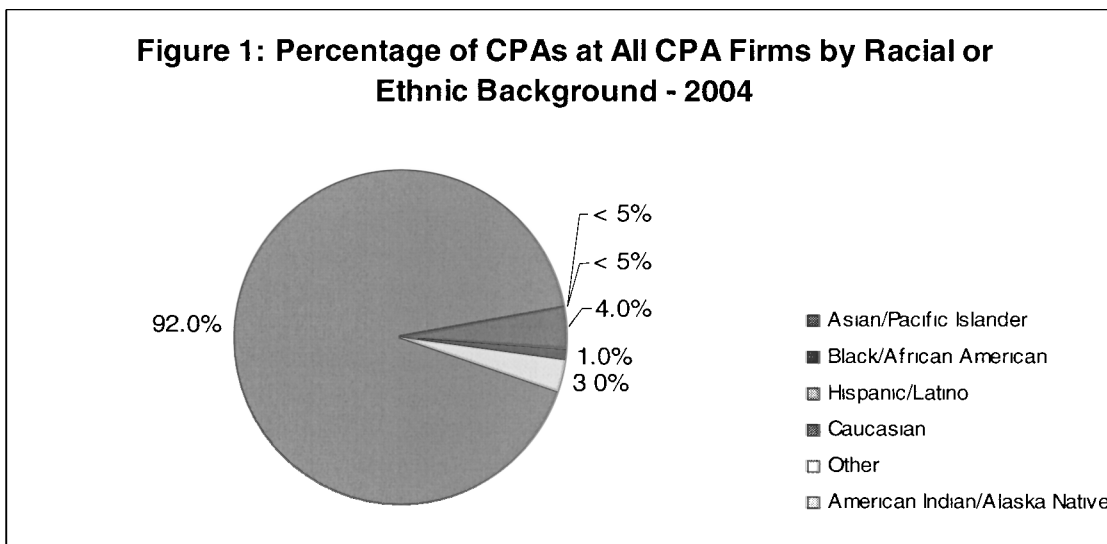
profession is undertaking significant efforts to hire and retain females and notes that these issues are being much better managed today. See, e.g., Record of Proceedings (June 3, 2008) (Oral Remarks of Amy Woods Brinkley, Global Risk Executive, Bank of America Corporation, 57), available at <http://www.treas.gov/offices/domestic-finance/acap/agendas/minutes-06-03-08.pdf> (noting that the Committee spent considerable time discussing this issue of females in the profession); Record of Proceedings (June 3, 2008) (Written Submission of Kayla J. Gillan, Chief Administrative Officer, RiskMetrics Group, 2), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Gillan060308.pdf> (urging the Committee to examine the issue of females in the profession); Record of Proceedings (June 3, 2008) (Oral Remarks of Anne M. Lang, Chief Human Resources Officer, Grant Thornton LLP, 100-101), available at <http://www.treas.gov/offices/domestic-finance/acap/agendas/minutes-06-03-08.pdf> (stating that " * * * certainly recruiting women into the profession is something that [Grant Thornton LLP has] done extremely well for the last several years * * * [the] advancement of * * * women is something that [Grant Thornton LLP] still need[s] to pay attention to"). The Committee notes the following statistics: In 2007, at the partner level, females represented 23% of partners on average, while in 2004 they were 19% and in 1994 they were just 12% of all partners. See American Institute of Certified Public Accountants, A Decade of Changes in The Accounting Profession: Workforce Trends and Human Capital Practices 5 (Feb. 2006) and Dennis R. Reigle, Heather L. Bunning And Danielle Grant, 2008 Trends In The Supply of Accounting Graduates And The Demand For Public Accounting Recruits 60 (2008), available at http://ceae.aicpa.org/NR/rdonlyres/C1E23302-17D3-4ED5-AE81-B274D9CD7812/0/AICPA_Trends_Reports_2008.pdf. According to Public Accounting Report surveys, the percentage of female professionals at the largest firms was 47.3% in 2007 and 44.2% in 2004. See Women at Big Four Gain Ground in Partnership Percentage, Public Accounting Report 6 (Oct. 31, 2004) and Women Post Gains in Partnership Percentage, Public Accounting Report 11 (Jan. 31, 2008). From 2005 to 2007, women represented about half of the new hires at the six largest firms. See Center For Audit Quality, Report Of The Major Public Company Audit Firms To The Department Of The Treasury Advisory Committee On The Auditing Profession 58 (Jan. 23, 2008). The Committee also considered the effects of workload compression on retention in the profession. Some Committee members believe that audit firms and their clients could benefit from spreading tax preparation work throughout the year. See, e.g., Record of Proceedings (Oct. 15, 2007) (Oral Remarks of William D. Travis, Director and Former Managing Partner, McCladrey & Pullen LLP, 71), available at <http://www.treas.gov/offices/domestic-finance/acap/agendas/minutes-10-15-07.pdf> (noting that "[a] significant challenge for retention of personnel in mid-size and small audit firms is the extreme seasonality * * * during the winter season. This reality places enormous pressure on audit quality and balanced lives of * * * professionals"); Record of Proceedings (Mar. 13, 2008) (Oral Remarks of Barry C. Melancon, President and Chief Executive Officer, American Institute of Certified Public Accountants, 118), available at <http://www.treas.gov/offices/domestic-finance/acap/agendas/minutes-03-13-08.pdf> (noting that the Human Capital Subcommittee discussed workload compression issues).

³⁹ See, e.g., Record of Proceedings (Dec. 3, 2007) (Written Submission of Ira Solomon, R.C. Evans

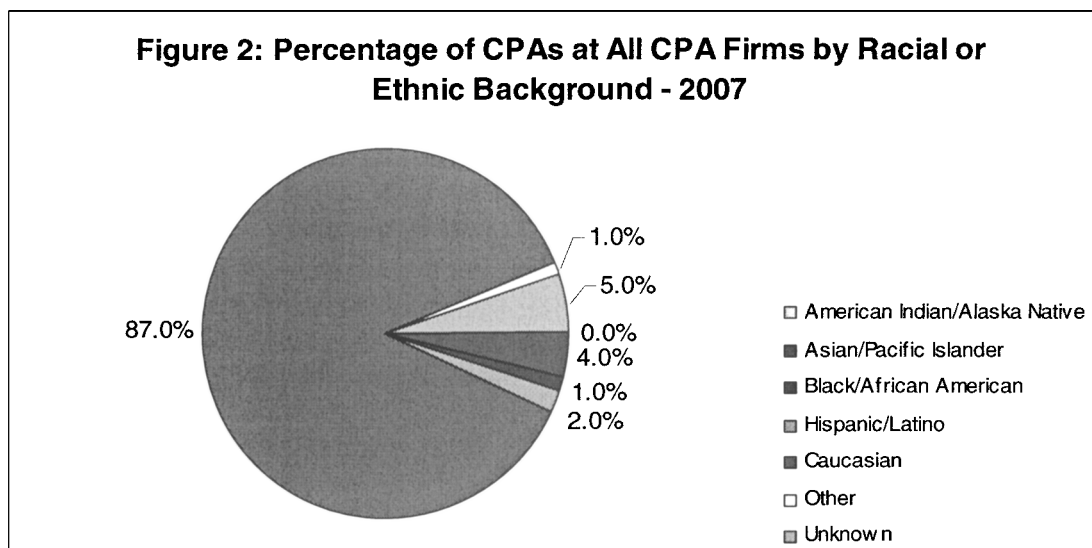
2004, minorities accounted for 22% of all bachelor's and masters' degrees awarded in accounting, while in 2007, minorities accounted for 21%.⁴⁰ In

2004, African Americans represented 1% of all CPAs, Hispanic/Latino, 3%, and Asian/Pacific Islander, 4%.⁴¹ See Figure 1. These percentages changed

very little in 2007 when African Americans represented 1% of all CPAs, Hispanic/Latino, 2%, and Asian/Pacific Islander, 4%.⁴² See Figure 2.



Source: BEATRICE SANDERS, AND LETICIA B. ROMEO, THE SUPPLY OF ACCOUNTING GRADUATES AND THE DEMAND FOR PUBLIC ACCOUNTING RECRUITS-2005: FOR ACADEMIC YEAR 2003-2004 35 (2005).



Source: DENNIS R. REIGLE, HEATHER L. BUNNING AND DANIELLE GRANT, 2008 TRENDS IN THE SUPPLY OF ACCOUNTING GRADUATES AND THE DEMAND FOR PUBLIC ACCOUNTING RECRUITS 61 (2008).

African Americans accounted for 5.4% of new hires in 2007 at the largest

Distinguished Professor, and Head, Department of Accountancy, University of Illinois, 13), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Solomon120307.pdf>; Record of Proceedings (Dec. 3, 2007) (Questions for the Record of George S. Willie, Managing Partner, Bert Smith & Co., 2 (Jan. 30, 2008)), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Willie120307.pdf>; Record of Proceedings (Dec. 3, 2007) (Written Submission of Julie K. Wood, Chief People Officer, Crowe Chizek and Company LLC, 2), available at

<http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Wood120307.pdf>.

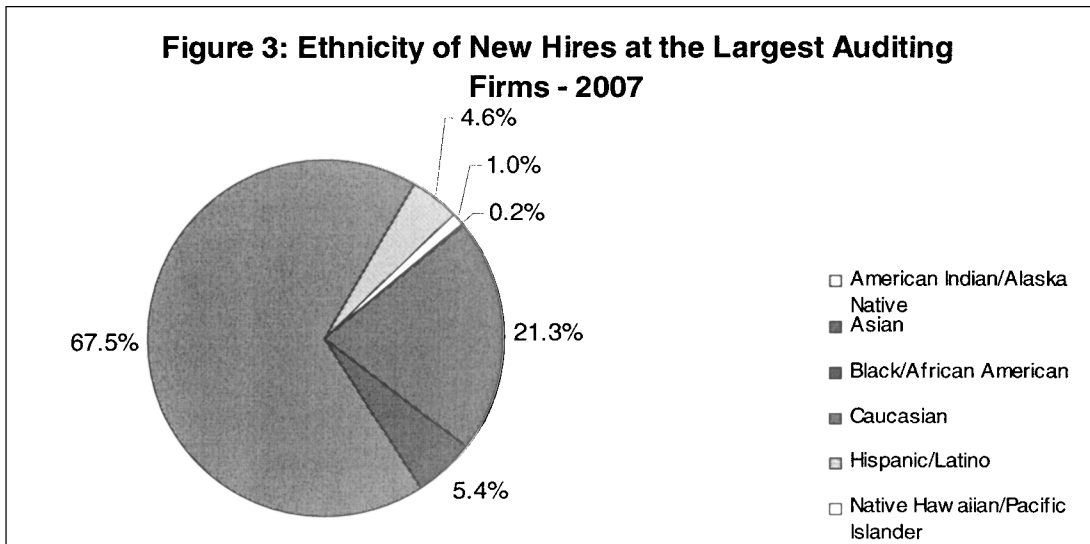
⁴⁰ Dennis R. Reigle, Heather L. Bunning And Danielle Grant, 2008 Trends In The Supply Of Accounting Graduates And The Demand For Public Accounting Recruits 30 (2008), available at http://ceae.aicpa.org/NR/rdonlyres/C1E23302-17D3-4ED5-AE81-B274D9CD7812/0/AICPA_Trends_Reports_2008.pdf.

⁴¹ Beatrice Sanders, And Leticia B. Romeo, The Supply Of Accounting Graduates And The Demand For Public Accounting Recruits-2005: For

Academic Year 2003-2004 35 (2005), available at http://ceae.aicpa.org/NR/rdonlyres/11715FC6-F0A7-4AD6-8D28-6285CBE77315/0/Supply_DemandReport_2005.pdf.

⁴² Dennis R. Reigle, Heather L. Bunning And Danielle Grant, 2008 Trends In The Supply Of Accounting Graduates And The Demand For Public Accounting Recruits 61 (2008), available at http://ceae.aicpa.org/NR/rdonlyres/C1E23302-17D3-4ED5-AE81-B274D9CD7812/0/AICPA_Trends_Reports_2008.pdf.

six accounting firms, Hispanics, 4.6%, and Asians, 21.3%.⁴³ See Figure 3.

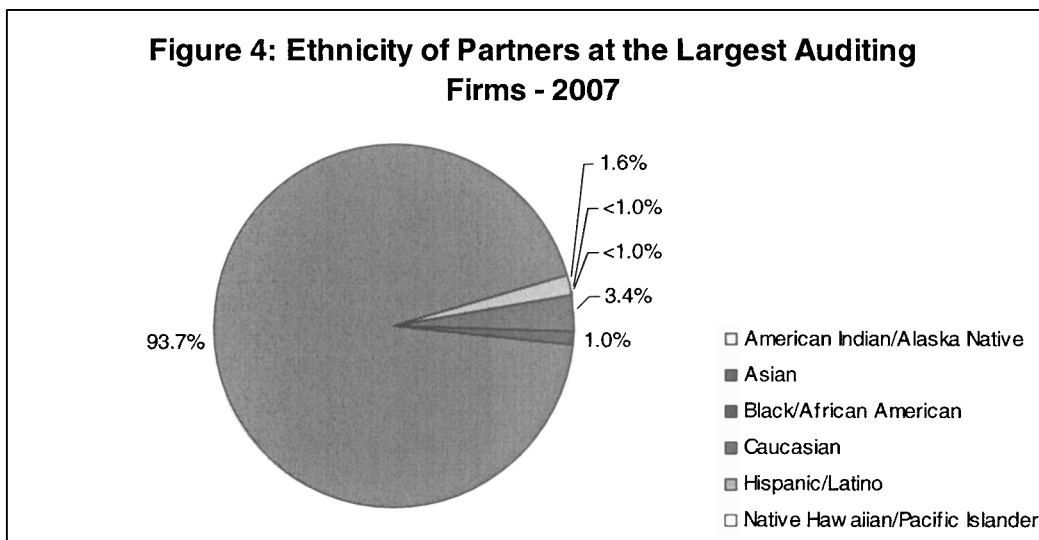


Source: CENTER FOR AUDIT QUALITY, REPORT OF THE MAJOR PUBLIC COMPANY AUDIT FIRMS TO THE DEPARTMENT OF THE TREASURY ADVISORY COMMITTEE ON THE AUDITING PROFESSION 59 (Jan. 23, 2008).

In 2007, 1.0% of the partners in the six largest accounting firms were African American, 1.6% were Hispanic/

Latino, 3.4% were Asian, and less than 1.0% were Native Hawaiian/Pacific Islander or American Indian/Alaska

Native, aggregating less than 7% of the total partners.⁴⁴ See Figure 4.



Source: CENTER FOR AUDIT QUALITY, REPORT OF THE MAJOR PUBLIC COMPANY AUDIT FIRMS TO THE DEPARTMENT OF THE TREASURY ADVISORY COMMITTEE ON THE AUDITING PROFESSION 60 (Jan. 23, 2008).

The Committee recognizes that important groups within the minority population are significantly under-represented in the accounting and auditing profession, especially at senior levels, and this under-representation of

minorities in the profession is unacceptable from both a societal and business perspective. As the demographics of the global economy continue to expand ethnic diversity, it is imperative that the profession also

reflect these changes. The auditing profession's historic role in performing audits in an increasingly diverse global setting and in establishing investor trust cannot be maintained unless the profession itself is viewed as open and

⁴³ Center For Audit Quality, Report Of The Major Public Company Audit Firms To The Department Of The Treasury Advisory Committee On The Auditing Profession 59 (Jan. 23, 2008), available at

<http://www.thecaq.org/publicpolicy/data/TRData2008-01-23-FullReport.pdf>.

⁴⁴ Center For Audit Quality, Report Of The Major Public Company Audit Firms To The Department

Of The Treasury Advisory Committee On The Auditing Profession 60 (Jan. 23, 2008), available at <http://www.thecaq.org/publicpolicy/data/TRData2008-01-23-FullReport.pdf>.

representative. To ensure the continued health and vibrancy of the profession, it is imperative that all participants in the financial, investor, educator, and auditor community adopt and implement policies, programs, practices, and curricula designed to attract and retain minorities. In order for minority participation in the accounting and auditing profession to grow and sustain itself, minority recruitment and retention needs to be a multi-faceted, multi-year effort, implemented and championed by community leaders, families, and most importantly business and academic leaders who educate, recruit, employ, and rely on accountants and auditors.

In this regard, the Committee recognizes the importance of setting goals and measuring progress against these goals and thus makes the following recommendations:

(a) Recruit minorities into the auditing profession from other disciplines and careers.

The Committee heard from witnesses that the auditing profession has “fallen short” on its minority recruitment goals.⁴⁵ Accordingly, the Committee recommends that auditing firms actively market to and recruit from minority non-accounting graduate populations, both at the entry and experienced hire level, utilizing cooperative efforts by academics and firm-based training programs to assist in this process.⁴⁶ Generally, auditing firms hire individuals for the audit practice who are qualified to sit for the Uniform CPA Examination.⁴⁷

Further, the Committee recommends that auditing firms expand their recruitment initiatives at historically black colleges and universities (HBCUs), and explore the use of proprietary schools as another way to recruit minorities into the profession.⁴⁸

⁴⁵ See, e.g., Record of Proceedings (Dec. 3, 2007) (Written Submission of Julie K. Wood, Chief People Officer, Crowe Chizek and Company LLC, 2), available at

<http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Wood120307.pdf>.

⁴⁶ See Ernst & Young LLP, Comment Letter Regarding Draft Report and Draft Report Addendum 22 (June 27, 2008), available at http://comments.treas.gov/_files/EYACAPCommentLetterFINAL2.pdf (supporting this Recommendation).

⁴⁷ See Record of Proceedings (Dec. 3, 2007) (Questions for the Record of James S. Turley, Chairman and Chief Executive Officer, Ernst & Young LLP, 4 (Feb. 1, 2008)), available at <http://www.treas.gov/offices/domestic-finance/acap/QFRs-12-3-07.pdf> (noting that since 1997, Ernst & Young LLP has typically hired individuals qualified to sit for the Uniform CPA Examination).

⁴⁸ Record of Proceedings (June 3, 2008) (Written Submission of Frank K. Ross, Director, Center for Accounting Education, Howard University School of Business, 3), available at

Currently over 100 educational institutions established before 1964 to serve the African American community are designated as HBCUs and over fifty of these HBCUs maintain accounting programs. Approximately 290,000 students are enrolled in HBCUs⁴⁹ and HBCUs enroll 14% of all African American students in higher education.⁵⁰ Twenty-seven HBCUs have one or more of the six largest accounting firms recruiting professional staff on their campus.⁵¹ Both the number of these schools visited by the largest firms and the number of firms recruiting at these schools should increase. Proprietary schools are for-profit businesses that teach vocational or occupational skills and there are over 2,000 proprietary schools in the United States.⁵² In 2005, these schools enrolled over 1 million students: African Americans accounted for 23% of these students, Hispanics, 13%, and Asian/Pacific Islander, 4%.⁵³

(b) Institute initiatives to increase the retention of minorities in the profession.

The Committee considered testimony on the retention of minorities in the profession.⁵⁴ As discussed above, minorities are significantly under-represented in leadership and

<http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Ross060308.pdf> (agreeing that this Recommendation will help increase minority recruitment).

⁴⁹ Stephen Provasnik and Linda L. Shafer, *Historically Black Colleges and Universities, 1976 to 2001 2* (NCES 2004-062), available at <http://nces.ed.gov/pubs2004/2004062.pdf>.

⁵⁰ White House Initiative On Historically Black Colleges And Universities, available at <http://www.ed.gov/about/inits/list/whhbcu/edlite-index.html>.

⁵¹ Center For Audit Quality, Supplement To Report Of The Major Public Company Audit Firms To The Department Of The Treasury Advisory Committee On The Auditing Profession 1 (Mar. 5, 2008), available at <http://www.thecaq.org/publicpolicy/data/TRData2008-03-05-Supplement1.pdf>.

⁵² Thomas D. Snyder, Sally A. Dillow, And Charlene M. Hoffman, *Digest Of Education Statistics 2007 Table 5* (NCES 2008-022), available at <http://nces.ed.gov/pubs2008/2008022.pdf>.

⁵³ Thomas D. Snyder, Sally A. Dillow, And Charlene M. Hoffman, *Digest Of Education Statistics 2007 Table 220* (NCES 2008-022), available at <http://nces.ed.gov/pubs2008/2008022.pdf>.

⁵⁴ Record of Proceedings (Dec. 3, 2007) (Written Submission of George S. Willie, Managing Partner, Bert Smith & Co., 3), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Willie120307.pdf> (noting that “firms must do more to retain and promote minority professionals”); Record of Proceedings (June 3, 2008) (Written Submission of Frank K. Ross, Director, Center for Accounting Education, Howard University School of Business, 8), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Ross060308.pdf> (noting that “auditing firms need to establish aggressive retention programs that focus on retention”).

partnership positions within the profession. The Committee recognizes the lack of minority mentors and role models⁵⁵ in the profession and the profession’s awareness of this situation.⁵⁶ In a 2006 National Association of Black Accountants (NABA) survey, almost 60% of African American respondents stated that their mentors come from outside of the profession and almost 55% of respondents stated that they had been with their current employer for three years or less.⁵⁷ The Committee considered testimony that African Americans leave the profession for other careers or do not wish to become managers or partners because they see that there are few African Americans in leadership positions within the firms.⁵⁸ The Committee also heard testimony that the retention rate for Hispanics “is low.”⁵⁹ In 2004, Hispanics represented 3% of the professional staff at all CPA

⁵⁵ Record of Proceedings (Feb. 4, 2008) (Written Submission of Gilbert R. Vasquez, Managing Partner, Vasquez & Company LLP, 4), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Vasquez02042008.pdf> (highlighting the lack of Hispanic role models and mentors in the accounting profession).

⁵⁶ See Record of Proceedings (July 12, 2006) (Written Testimony of Manuel Fernandez, National Managing Partner—Campus Recruiting, KPMG LLP, to the Subcommittee on Oversight and Investigations of the House Financial Services Committee, 5), available at <http://financialservices.house.gov/media/pdf/071206mf.pdf> (identifying the lack of minority faculty mentors and role models and noting “[w]hen students of color do not see professors of their own ethnic background on the accounting faculty, they are less apt to consider the option of a career in accountancy”); Record of Proceedings (Dec. 3, 2007) (Questions for the Record of George S. Willie, Managing Partner, Bert Smith & Co., 1 (Jan. 30, 2008)), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Willie120307.pdf> (recommending the establishment of a mentor program for minority accounting students).

⁵⁷ The Center for Accounting Education, Howard University School of Business, NABA Membership Survey, Analysis of Work Experience of NABA Members Table 23 and 5 (Sept. 15, 2006), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/NABAMembershipSurvey.pdf>.

⁵⁸ Record of Proceedings (June 3, 2008) (Written Submission of Frank K. Ross, Director, Center for Accounting Education, Howard University School of Business, 5), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Ross060308.pdf>.

⁵⁹ Record of Proceedings (Feb. 4, 2008) (Written Submission of Gilbert R. Vasquez, Managing Partner, Vasquez & Company LLP, 4), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Vasquez02042008.pdf>.

firms⁶⁰ and this percentage did not change in 2007.⁶¹

The Committee believes that firms must continue to find ways to retain minorities in the profession in order to ensure the profession's long-term viability. The Committee believes the need to instill confidence is critical to an individual's career as is the need for mentors, especially at the start of an individual's career.⁶² The Committee also recognizes that auditing firms must continue to give challenging assignments so that individuals have the motivation to stay in the profession.⁶³ Thus, the Committee recommends that public company auditing firms intensify their efforts to create and maintain retention programs, including mentoring programs, for their employees as a means to provide these individuals with guidance, career coaching, and networking. Further, the Committee recommends that the profession compile and issue best practices related to minority recruitment and retention.⁶⁴

(c) Emphasize the role of community colleges in the recruitment of minorities into the auditing profession.

Community colleges are a vital part of the postsecondary education system.

⁶⁰ Beatrice Sanders, and Leticia B. Romeo, The Supply of Accounting Graduates and the Demand for Public Accounting Recruits—2005: For Academic Year 2003–2004 32 (2005), available at http://ceae.aicpa.org/NR/rdonlyres/11715FC6-F0A7-4AD6-8D28-6285CBE77315/0/Supply_DemandReport_2005.pdf.

⁶¹ Dennis R. Reigle, Heather L. Bunning and Danielle Grant, 2008 Trends in the Supply of Accounting Graduates and the Demand for Public Accounting Recruits 59 (2008), available at http://ceae.aicpa.org/NR/rdonlyres/C1E23302-17D3-4ED5-AE81-B274D9CD7812/0/AICPA_Trends_Reports_2008.pdf.

⁶² Record of Proceedings (June 3, 2008) (Written Submission of Frank K. Ross, Director, Center for Accounting Education, Howard University School of Business, 8), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Ross060308.pdf> (noting that “auditing firms need to establish aggressive retention programs that focus on confidence * * * the single greatest source of confidence is a good mentor. Unless [an individual has] been blessed with a truly strong mentor, it may be hard to understand how beneficial it is”).

⁶³ Record of Proceedings (June 3, 2008) (Oral Remarks of Anne M. Lang, Chief Human Resources Officer, Grant Thornton LLP, 83), available at <http://www.treas.gov/offices/domestic-finance/acap/agendas/minutes-06-03-08.pdf> (stating that “* * * what [Grant Thornton] find[s], at least in the research that we've done with people coming into the organization and staying in public accounting, is that meaningful and challenging work and the opportunity to advance, based on an individual's career aspirations, is really what keeps our people longer”).

⁶⁴ See PricewaterhouseCoopers LLP, Comment Letter Regarding the Draft Report and Draft Report Addendum 5 (June 30, 2008), available at http://comments.treas.gov/_files/PwCCommentLtrTreasCmtDraftandAddendum63008.pdf.

They provide open access to post-secondary education, preparing students for transfer to four-year institutions, providing workforce development and skills training, and offering non-credit programs. Moreover, as the cost of higher education continues its upward climb, more and more high-achieving students are beginning their post-secondary study through the community college system.

As of January 2008, approximately 11.5 million students were enrolled in the 1,200 community colleges in the United States: African Americans accounted for 13% of these students, Hispanics, 15%, and Asian/Pacific Islander, 6%.⁶⁵

In August 1992, the Accounting Education Change Commission (AECC), created in the late 1980s by the academic community to examine potential changes to accounting education, recognized the importance of two-year colleges in accounting education. The AECC noted that over half of all students taking their first course in accounting do so at two-year colleges and that approximately one-fourth of the students entering the accounting profession take their initial accounting coursework at two-year colleges. The AECC called for “greater recognition within the academic and professional communities of the efforts and importance of two-year accounting programs.”⁶⁶

The Committee also heard from witnesses emphasizing the need to expand minority recruitment initiatives at community colleges.⁶⁷

The Committee believes that more attention to community colleges may provide, in addition to an increase in the overall supply of students, another avenue for minorities to become familiar with and attracted to the auditing profession. Currently none of the largest

⁶⁵ American Association of Community Colleges, available at <http://www2.aacc.nche.edu/research/index.htm>.

⁶⁶ Accounting Education Change Commission, Issues Statement Number 3: The Importance of Two-Year Colleges for Accounting Education (Aug. 1992), available at <http://aaahq.org/aecc/PositionsandIssues/issues3.htm>.

⁶⁷ Record of Proceedings (Feb. 4, 2008) (Written Submission of Gilbert R. Vasquez, Managing Partner, Vasquez & Company LLP, 4), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Vasquez02042008.pdf> (noting that auditing firms overlook community colleges where minorities, and specifically Latinos, represent a large student population); Record of Proceedings (Dec. 3, 2007) (Questions for the Record of George S. Willie, Managing Partner, Bert Smith & Co., 2 (Jan. 30, 2008)), available at <http://www.treas.gov/offices/domestic-finance/acap/QFRs-12-3-07.pdf> (recommending that the auditing profession increase its visibility at community colleges).

auditing firms recruits at community colleges because “individuals who only have associate degrees typically will not have sufficient qualifications to satisfy state licensing requirements.”⁶⁸ The Committee recommends that accreditation of two-year college accounting programs at community colleges be explored and implemented when viable, so that these programs can be relied upon as one of the requisite steps toward fulfilling undergraduate educational requirements.⁶⁹ Further, the Committee recommends that auditing firms and educational institutions at all levels support and cooperate in building strong fundamental academic accounting programs at community colleges, including providing internships or financial support for students who begin their studies in two-year programs and may be seeking careers in the auditing profession. The Committee also recommends that auditing firms and four-year colleges and universities and their faculty focus on outreach to community college students in order to support students' transition from community colleges to four-year educational institutions.⁷⁰

(d) Emphasize the utility and effectiveness of cross-sabbaticals and internships with faculty and students at Historically Black Colleges and Universities.

As discussed above, African Americans are significantly under-represented in the auditing profession.

The Committee recommends encouraging a concerted effort to increase the focus upon HBCUs in order to raise the number of African Americans in the auditing profession and urging the HBCUs, auditing firms, corporations, federal and state

⁶⁸ Center for Audit Quality, Supplement to Report of the Major Public Company Audit Firms to the Department of the Treasury Advisory Committee on the Auditing Profession 1 (Mar. 5, 2008), available at <http://www.theacq.org/publicpolicy/data/TRData2008-03-05-Supplement1.pdf>.

⁶⁹ See Record of Proceedings (June 3, 2008) (Written Submission of Anne M. Lang, Chief Human Resources Officer, Grant Thornton LLP, 4), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Lang060308.pdf> (supporting the accreditation of community colleges).

⁷⁰ See, e.g., Cynthia M. Fornelli, Executive Director, Center for Audit Quality, Comment Letter Regarding Draft Report and Draft Report Addendum 8 (June 26, 2008), available at http://comments.treas.gov/_files/CAQCommentletter62708FINAL.pdf (stating that outreach programs to community colleges could be effective); PricewaterhouseCoopers LLP, Comment Letter Regarding Draft Report and Draft Report Addendum 5 (June 30, 2008), available at http://comments.treas.gov/_files/PwCCommentLtrTreasCmtDraftandAddendum63008.pdf (suggesting that the Committee recommend steps to transition students from community colleges to four-year colleges and universities).

governments, and other entities to emphasize the use of cross-sabbaticals.⁷¹ Cross-sabbaticals are interactive relationships where faculty and seasoned professionals are regularly represented in the practice and academic environments through exchanges. Evidence suggests that such exchanges can be beneficial, and continued development of such exchanges is expected to provide substantial benefits for all parties.⁷² Cross-sabbaticals present an opportunity for “reflective thinking” for seasoned professionals.⁷³

In addition, the Committee recommends that the over fifty HBCUs with accounting programs require one member of their accounting faculty annually to participate in a cross-sabbatical with a private or public sector entity. The Committee also recommends that the private and public sector entities provide these opportunities, as well as focus on other arrangements to build relationships at these educational institutions.

The Committee received testimony regarding the lack of minority mentors and role models⁷⁴ and notes that the

⁷¹ See Cynthia M. Fornelli, Executive Director, Center for Audit Quality, Comment Letter Regarding Draft Report and Draft Report Addendum 8 (June 26, 2008), available at http://comments.treas.gov/_files/CAQCommentLetter62708FINAL.pdf (agreeing with this Recommendation).

⁷² See Record of Proceedings (Feb. 4, 2008) (Written Submission of Cynthia Fornelli, Executive Director, Center for Audit Quality, 2), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Fornelli020408.pdf> (recommending encouraging sabbaticals, internships, and fellowship opportunities, structured to give faculty opportunities to conduct research for promotion and tenure); Record of Proceedings (Feb. 4, 2008) (Oral Remarks of Phillip M.J. Reckers, Professor of Accountancy, Arizona State University, 68), available at <http://www.treas.gov/offices/domestic-finance/acap/agendas/minutes-2-4-08.pdf> (stating that sabbaticals deliver professors “a wealth of knowledge they could bring back in the classroom”).

⁷³ See Record of Proceedings (Mar. 13, 2008) (Oral Remarks of H. Rodgin Cohen, Chairman, Sullivan & Cromwell LLP, 69), available at <http://www.treas.gov/offices/domestic-finance/acap/agendas/minutes-03-13-08.pdf> (noting that spending time in the classroom should “give the [practicing accountant] the time to do the reflective thinking”); Record of Proceedings (Mar. 13, 2008) (Oral Remarks of Zoe-Vonna Palmrose, Deputy Chief Accountant, SEC), available at <http://www.treas.gov/offices/domestic-finance/acap/agendas/minutes-03-13-08.pdf> (commenting that sabbaticals provide the “opportunity for reflective thinking”).

⁷⁴ See, e.g., Record of Proceedings (June 3, 2008) (Written Submission of Frank K. Ross, Director, Center for Accounting Education, Howard University School of Business, 9), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Ross060308.pdf> (highlighting that a 2006 NABA survey revealed that almost 60% of African American respondents

profession has recognized this situation.⁷⁵ Thus, the Committee also recommends that public company auditing firms intensify their efforts to create internships and mentoring programs for students in accounting and other complementary disciplines, including those from HBCUs and community colleges, as a means to increase the awareness of the accounting profession and its attractiveness among minority students.

(e) Increase the numbers of minority accounting doctorates through focused efforts.

Some dedicated programs have succeeded in attracting minorities to enter and complete accounting doctoral studies.⁷⁶ In particular, the PhD Project, an effort of the KPMG Foundation, has worked to increase the diversity of business school faculty.⁷⁷ The PhD Project focuses on attracting minorities to business doctoral programs, and provides a network of peer support. Since the PhD Project’s establishment in 1994, the number of minority professors at U.S. business schools has increased from 294 to 889.⁷⁸ Ninety percent who enter the PhD Project earn their doctorates, and 99% of those who complete their doctorates go on to

stated that their mentors come from outside of the profession); Record of Proceedings (Feb. 4, 2008) (Written Submission of Gilbert R. Vasquez, Managing Partner, Vasquez & Company LLP, 4), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Vasquez02042008.pdf> (highlighting the lack of Hispanic role models and mentors in the accounting profession).

⁷⁵ See Record of Proceedings (July 12, 2006) (Written Testimony of Manuel Fernandez, National Managing Partner—Campus Recruiting, KPMG LLP, to the Subcommittee on Oversight and Investigations of the House Financial Services Committee, 5), available at <http://financialservices.house.gov/media/pdf/071206mf.pdf> (identifying the lack of minority faculty mentors and role models and noting “[w]hen students of color do not see professors of their own ethnic background on the accounting faculty, they are less apt to consider the option of a career in accountancy”); Record of Proceedings (Dec. 3, 2007) (Questions for the Record of George S. Willie, Managing Partner, Bert Smith & Co., 1 (Jan. 30, 2008)), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Willie120307.pdf> (recommending the establishment of a mentor program for minority accounting students).

⁷⁶ For a list of educational support programs that auditing firms are sponsoring, see Record of Proceedings (Feb. 4, 2008) (Written Submission of Barry Salzberg, Chief Executive Officer, Deloitte LLP, Appendix A), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Salzberg020408.pdf>.

⁷⁷ For further information on the PhD Project, see <http://www.phdproject.org/mission.html>.

⁷⁸ Record of Proceedings (Feb. 4, 2008) (Written Submission of Barry Salzberg, Chief Executive Officer, Deloitte LLP, Appendix A), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Salzberg020408.pdf>.

teach.⁷⁹ The PhD Project has received over \$17.5 million⁸⁰ in funding since 1994 from corporations, foundations, universities, and other interested parties.⁸¹

The Committee believes that programs such as these can successfully recruit minorities to accounting doctoral studies. The Committee recommends that auditing firms, corporations, and other interested parties advertise existing and successful efforts to increase the number of minority doctorates by developing further dedicated programs.⁸² Additionally, the Committee recommends that auditing firms, corporations, and other interested parties maintain and increase the funding of these programs.

Recommendation 3. Ensure a sufficiently robust supply of qualified accounting faculty to meet demand for the future and help prepare new entrants to the profession to perform high quality audits.

The Committee heard testimony from individuals regarding the need to have an adequate supply of faculty with the knowledge and experience to develop qualified professionals for the increasingly complex and global auditing profession.⁸³

⁷⁹ See Jane Porter, Going to the Head of the Class: How the PhD Project is Helping to Boost the Number of Minority Professors in B-schools, Business Week Online (Dec. 27, 2006), available at http://www.businessweek.com/bschools/content/dec2006/bs20061227_926455.htm.

⁸⁰ See Record of Proceedings (July 12, 2006) (Written Testimony of Manuel Fernandez, National Managing Partner—Campus Recruiting, KPMG LLP, to the Subcommittee on Oversight and Investigations of the House Financial Services Committee, 5), available at <http://financialservices.house.gov/media/pdf/071206mf.pdf>.

⁸¹ For further information on the PhD Project, see http://www.phdproject.org/corp_sponsors.html.

⁸² See, e.g., Cynthia M. Fornelli, Executive Director, Center for Audit Quality, Comment Letter Regarding Draft Report and Draft Report Addendum 9 (June 26, 2008), available at http://comments.treas.gov/_files/CAQCommentLetter62708FINAL.pdf (stating that this Recommendation could lead to an increase in the number of minority accounting doctorates); Record of Proceedings (June 3, 2008) (Written Submission of Frank K. Ross, Director, Center for Accounting Education, Howard University School of Business, 11), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Ross060308.pdf> (noting the need to expand support for the PhD Project and similar initiatives).

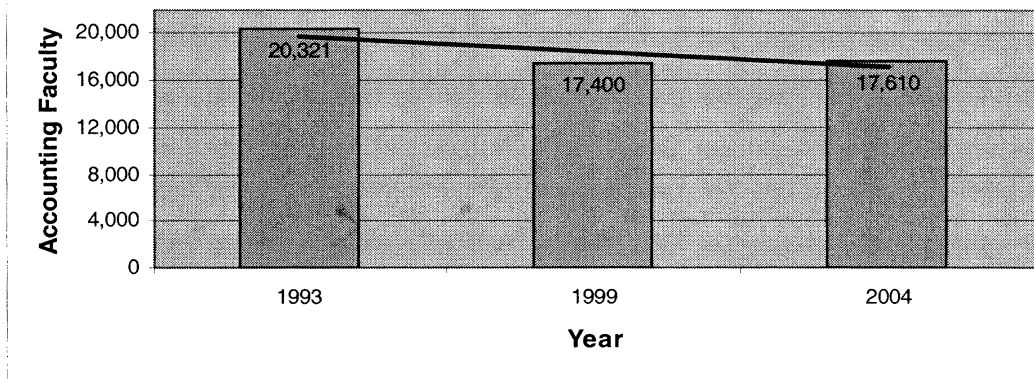
⁸³ See, e.g., Record of Proceedings (Dec. 3, 2007) (Written Submission of David W. Leslie, Chancellor Professor of Education, College of William and Mary, 2), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Leslie120307.pdf> (noting a 13.3% decline in accounting faculty from 1988 to 2004); Record of Proceedings (Feb. 4, 2008) (Written Submission of Edward E. Nusbaum, Chief Executive Officer, Grant Thornton LLP, and Chairman, Grant Thornton International Board of Governors, 5), available at <http://www.treas.gov/offices/domestic-finance/>

The Committee recognizes that there is a high level of concern about the adequacy of both the near- and the long-term supply of doctoral faculty, especially given the anticipated pace of

faculty retirements. According to National Study of Postsecondary Faculty data, the number of full- and part-time accounting faculty at all types of educational institutions fell by 13.3%

from 20,321 in 1993 to 17,610 in 2004, while student (undergraduate) enrollment increased by 12.3% over the same period.⁸⁴ See Figure 5.

Figure 5: Number of Full- and Part-time Accounting Faculty at All Types of Institutions, 1993 - 2004



Source: ADVISORY COMMITTEE ON THE AUDITING PROFESSION, RECORD OF PROCEEDINGS (DEC. 3, 2007) (WRITTEN SUBMISSION OF DAVID W. LESLIE, CHANCELLOR PROFESSOR OF EDUCATION, COLLEGE OF WILLIAM AND MARY, 5).

Moreover, the current pipeline of doctoral faculty is not keeping pace with anticipated retirements. In November 2006, it was estimated that one-third of the approximately 4,000 accounting doctoral faculty in the United States were 60 years old or older, and one-half were 55 years old or older.⁸⁵ The average retirement age of accounting faculty was 62.4 years.

In terms of specialization within the accounting discipline, an AAA study concluded that only 22% and 27% of the projected demand for doctoral faculty in auditing and tax, respectively, will be met by expected graduations in the coming years.⁸⁶ However, 91% and 79% of the projected demand for doctoral faculty in financial accounting

and managerial accounting, respectively, will be met.⁸⁷

In addition to the accounting faculty supply issues, the Committee heard testimony from witnesses on the need to ensure faculty are qualified and able to teach students the latest market developments, such as fair value accounting and IFRS. The Committee learned that often new accounting faculty may have little practical experience.⁸⁸ Witnesses testified to the difficulty of academics acquiring "practice-oriented" knowledge as the bond between the profession and academia is underdeveloped. Witnesses did suggest improving these relationships with incentives for sabbaticals and sharing practice experience.⁸⁹

In this regard, the Committee makes the following recommendations:

(a) Increase the supply of accounting faculty through public and private funding and raise the number of professionally qualified faculty that teach on campuses.

The Committee recognizes that ensuring an adequate supply of doctoral accounting faculty in higher education is crucial to both retaining the academic standing of the discipline on campus and developing well-prepared and educated entry-level professionals. The resource represented by these professionals is essential for high quality audits. The Committee believes that high quality audits are critical to well-functioning capital markets, and therefore the funding necessary to

acap/submissions/02042008/Nusbaum020408.pdf (stating that "recent years have seen a reduction in accounting faculty, based on a wave of retirements and lack of accounting PhDs coming into the system"); Record of Proceedings (Dec. 3, 2007) (Written Submission of Ira Solomon, R.C. Evans Distinguished Professor, and Head, Department of Accountancy, University of Illinois, 4), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Solomon120307.pdf> (stating that "the number of persons entering accountancy doctoral programs is too low to sustain the accountancy professoriate").

⁸⁴ Record of Proceedings (Dec. 3, 2007) (Written Submission of David W. Leslie, Chancellor Professor of Education, College of William and Mary, 5), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Leslie120307.pdf>.

⁸⁵ James R. Hasselback, 2007 Analysis of Accounting Faculty Birthdates, available at <http://aaahq.org/temp/phd/JimHasselbackBirthdateSlide.pdf>.

⁸⁶ R. David Plumlee, Steven J. Kachelmeier, Silvia A. Madeo, Jamie H. Pratt, and George Krull, Assessing the Shortage of Accounting Faculty, 21 Issues in Accounting Education, No. 2, 119 (May 2006).

⁸⁷ R. David Plumlee, Steven J. Kachelmeier, Silvia A. Madeo, Jamie H. Pratt, and George Krull, Assessing the Shortage of Accounting Faculty, 21 Issues in Accounting Education, No. 2, 119 (May 2006).

⁸⁸ Record of Proceedings (Dec. 3, 2007) (Written Submission of Joseph V. Carcello, Director of Research, Corporate Governance, University of Tennessee, Knoxville, 21), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Carcello120307.pdf>.

⁸⁹ Record of Proceedings (Feb. 4, 2008) (Written Submission of Cynthia Fornelli, Executive Director, Center for Audit Quality, 2), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Fornelli020408.pdf> (noting that the auditing firms recognize the need to be more active in sharing practical experiences with academics); Record of Proceedings (Feb. 4, 2008) (Written Submission of Phillip M.J. Reckers, Professor of Accountancy, Arizona State University, 19), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Reckers020408.pdf> ("[R]elationships between practitioners and academics have so diminished that they are little more than formal liaison assignments involving very few parties from any side * * * [w]here there have been opportunities for interaction (curriculum issues, policy deliberations, research matters), those opportunities have been embraced perceptibly less often.").

supply the healthy pipeline of doctoral accounting faculty to assist in providing these human capital resources must be made available.⁹⁰ The Committee therefore recommends expanding government funding, at both the federal and state level, for accounting doctoral candidates. The Committee also recommends that private sources (including corporations, institutional investors, and foundations as well as auditing firms) continue to be encouraged to fund accounting doctoral candidates.⁹¹ The Committee recognizes and commends the auditing firms' support of doctoral candidates.⁹²

⁹⁰ See Record of Proceedings (June 3, 2008) (Written Submission of Jean C. Bedard, Timothy B. Harbert Professor of Accounting, Department of Accountancy, Bentley College, 2), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Bedard060308.pdf> (noting that "[f]unding for doctoral study is absolutely critical").

⁹¹ See, e.g., Record of Proceedings (June 3, 2008) (Written Submission of Kayla J. Gillan, Chief Administrative Officer, RiskMetrics Group, 2), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Gillan060308.pdf> (noting that Sarbanes-Oxley Act Section 109(c)(2) states that monetary penalties assessed by the PCAOB against registered firms and individuals are to be used exclusively to fund merit-based scholarships for accounting undergraduate and graduate students and that Section 109(c)(2) also includes certain procedural requirements for the funds' release, such as Congressional approval, and recommending the Committee suggest eliminating the unnecessary procedural obstacles contained in the statute); PricewaterhouseCoopers LLP, Comment Letter Regarding Draft Report and Draft Report Addendum 6 (June 30, 2008), available at http://comments.treas.gov/_files/PwCCommentLtrTreasCmtDraftandAddendum63008.pdf (noting that the profession provides funding for faculty, but other private sector participants as well as Congress and state and local officials could contribute funding).

⁹² See Record of Proceedings (Feb. 4, 2008) (Written Submission of Cynthia Fornelli, Executive Director, Center for Audit Quality, 2), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Fornelli020408.pdf>. Other commenters have suggested another method to increase the number of faculty and professionals as well as potentially expand diversity within the profession is by increasing the current H-1B quota of 65,000. See, e.g., Cynthia M. Fornelli, Executive Director, Center for Audit Quality, Comment Letter Regarding Draft Report and Draft Report Addendum 9 (June 26, 2008), available at http://comments.treas.gov/_files/CAQCommentLetter62708FINAL.pdf (noting the need to increase the quota for H-1B visas to help increase the number of faculty and the number of professionals knowledgeable of international issues); PricewaterhouseCoopers LLP, Comment Letter Regarding Draft Report and Draft Report Addendum 7 (June 30, 2008), available at http://comments.treas.gov/_files/PwCCommentLtrTreasCmtDraftandAddendum63008.pdf (recommending immigration reform, such as expansion of H-1B visa program, to increase supply of accounting faculty, international experience, and diversity). But, c.f., Carl Olson, California National University, Comment Letter Regarding Draft Report and Draft Report Addendum 31-32 (June 6, 2008), available at http://comments.treas.gov/_files/OlsonCommentLetter0606082.pdf (opposing the use of H-1B visas by accounting firms to recruit employees).

Currently, minimum accreditation requirements for accountancy faculty typically require that approximately 50% of full-time faculty have a doctoral degree. Commonly, business school deans and academic vice presidents (those making the budgetary decisions regarding faculty allotments on campuses) interpret this accreditation requirement to require that a minimum of 50% of a department's faculty hold an earned doctorate and are actively engaged in research and publication activity. Although a high percentage of faculty is expected to be professionally qualified (i.e., having recent direct business experience), at times gatekeepers for budget allocations may be less enthusiastic about maximizing the number of professionally qualified teaching slots in a given program. The Committee sees benefits to the increased participation of professionally qualified and experienced faculty, who would bring additional practical business experience to the classrooms, and notes that witnesses and commenters have underscored the benefits of professionally qualified and experienced faculty.⁹³ Therefore, the Committee recommends that accrediting agencies continue to actively support faculty composed of academically and professionally qualified and experienced faculty.

(b) Emphasize the utility and effectiveness of cross-sabbaticals.

As discussed above, cross-sabbaticals are interactive relationships where faculty and seasoned professionals are regularly represented in the practice and academic environments through exchanges. For example, currently, the Securities and Exchange Commission (SEC) and the FASB offer fellowship programs for professional accountants and accounting academics. Evidence suggests that such exchanges can be beneficial, and continued development of such exchanges is expected to provide substantial benefits for all

⁹³ See Andrew D. Bailey, Jr., Professor of Accountancy-Emeritus, University of Illinois, and Senior Policy Advisor, Grant Thornton LLP, Comment Letter Regarding Discussion Outline 19 (Jan. 30, 2008), available at http://comments.treas.gov/_files/BAILEYCOMMENTSONTREASURYADVISORYCOMMITTEEOUTLINEFINALSUBMISSION13008.doc (stating that "[t]here are clearly practice professionals that make excellent contributions to some of the most highly rated accounting programs in the country"); Record of Proceedings (Feb. 4, 2008) (Written Submission of Cynthia Fornelli, Executive Director, Center for Audit Quality, 3), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Fornelli020408.pdf> (stating that accreditation bodies "revise accreditation standards to allow the employment of more audit professionals, either active or retired, as adjunct professors").

parties.⁹⁴ Cross-sabbaticals present an opportunity for "reflective thinking" for seasoned professionals.⁹⁵ Academics often face the disincentive of being forced to forgo their full salaries in order to engage in such sabbaticals,⁹⁶ and colleges and universities may not encourage professional practice sabbaticals, preferring that the focus of faculty be directed exclusively toward academic research and the number and placement of scholarly articles. The Committee believes that changing both the academic and practice culture will require a plan and commitment of support at the highest institutional levels.

Specifically, the Committee recommends that educational institutions, auditing firms, corporations, federal and state regulators, and others engage in a two-fold strategy to both encourage cross-sabbaticals and eliminate financial or career disincentives for participating in such experiences.⁹⁷ Further, the

⁹⁴ See Record of Proceedings (Feb. 4, 2008) (Written Submission of Cynthia Fornelli, Executive Director, Center for Audit Quality, 2), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Fornelli020408.pdf> (recommending encouraging sabbaticals, internships, and fellowship opportunities, structured to give faculty opportunities to conduct research for promotion and tenure); Record of Proceedings (June 3, 2008) (Written Submission of William Kinney, Charles & Elizabeth Prothro Regents Chair in Business and Price Waterhouse Fellow in Auditing, University of Texas, Austin, 5), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Kinney060308.pdf> (noting the completion of an August 2007 to February 2008 assignment as an academic fellow in the Professional Practice Group of Office of Chief Accountant at the SEC, and stating that the experience provided a greater understanding of the regulatory process and that "my students have already benefited through more relevant classes"); Record of Proceedings (Feb. 4, 2008) (Oral Remarks of Phillip M.J. Reckers, Professor of Accountancy, Arizona State University, 68), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Reckers020408.pdf> (stating that sabbaticals deliver professors "a wealth of knowledge they could bring back in the classroom").

⁹⁵ See Record of Proceedings (Mar. 13, 2008) (Oral Remarks of H. Rodgin Cohen, Chairman, Sullivan & Cromwell LLP, 69), available at <http://www.treas.gov/offices/domestic-finance/acap/agendas/minutes-03-13-08.pdf>; Record of Proceedings (Mar. 13, 2008) (Oral Remarks of Zoe-Vonna Palmrose, Deputy Chief Accountant, SEC, 67), available at <http://www.treas.gov/offices/domestic-finance/acap/agendas/minutes-03-13-08.pdf>.

⁹⁶ Record of Proceedings (Feb. 4, 2008) (Oral Remarks of Phillip M.J. Reckers, Professor of Accountancy, Arizona State University, 67-69), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Reckers020408.pdf> (noting the financial disincentives associated with sabbaticals).

⁹⁷ See, e.g., Deloitte LLP, Comment Letter Regarding Draft Report and Draft Report Addendum 11 (June 27, 2008), available at <http://>

Committee recommends that university administrators place as high a value on professional sabbaticals for purposes of promotion and tenure as they do for research and scholarly publication.⁹⁸

The Committee also recommends that accrediting agencies establish an expectation that at least one full-time member per year of each accounting faculty group participate in a sabbatical with a private sector or a governmental entity. Auditing firms, corporations, government agencies, and universities should be expected to provide these opportunities with the elimination of any financial disincentives. Further, the Committee recommends expanding faculty fellowship programs in agencies, such as those at the SEC and the FASB, and making them available at the PCAOB. The successful long-term operation of these programs at the SEC and the FASB and the application of appropriate conflict-of-interest and recusal rules have demonstrated that these programs can be maintained and expanded while protecting against conflicts of interest.

(c) Create a variety of tangible and sufficiently attractive incentives that will motivate private sector institutions to fund both accounting faculty and faculty research, to provide practice materials for academic research and for participation of professionals in behavioral and field study projects, and to encourage practicing accountants to pursue careers as academically and professionally qualified faculty.

As discussed above, there are concerns about the adequate supply of accounting faculty and about the need to have faculty who can inject more

practical experience into classroom learning. Currently, there are few specific financial incentives encouraging private sector funding of accounting doctoral faculty or sponsoring of professional accountants to teach at educational institutions. Nonetheless, the Committee notes that the profession recognizes the need to support initiatives to increase faculty and is currently directing its efforts to raise funds for such a new initiative.⁹⁹

The Committee also heard from several witnesses regarding the unavailability of data relating to auditing practice and the impact this lack of data has on research and potentially on the profession's sustainability. In particular, witnesses stated that the decline in auditing research materials, including archival or experimental data, will lead to a further decline in faculty and doctoral students specializing in auditing.¹⁰⁰ Since educational institutions normally require publications in top tier journals for promotion or tenure, faculty and doctoral students will conduct research in accounting areas where data are prevalent.

The Committee also heard that encouraging more professionally

qualified and experienced faculty will foster a stronger relationship between academia and the profession.¹⁰¹ Currently, there exists a need for more interaction between academia and the profession.¹⁰² Encouraging practicing accountants to pursue careers as academically and professionally qualified faculty would bring practical business experience to classrooms so that students are better prepared to perform quality audits in the dynamic business environment.

Finally, the Committee recommends that Congress pass legislation creating a variety of tangible incentives for private sector institutions to establish support for accounting and auditing faculty and faculty research, to facilitate access to research data and individuals,¹⁰³ and to sponsor transition of professional accountants from practice to teaching positions. These incentives must be sufficiently attractive to companies and auditing firms to affect rapid behavioral change, and should avoid cumbersome levels of administration. The Committee believes that these incentives would

¹⁰¹ Record of Proceedings (Feb. 4, 2008) (Written Submission of Cynthia Fornelli, Executive Director, Center for Audit Quality, 2), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Fornelli020408.pdf>.

¹⁰² Record of Proceedings (Feb. 4, 2008) (Written Submission of Phillip M.J. Reckers, Professor of Accountancy, Arizona State University, 19), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Reckers020408.pdf>.

¹⁰³ See, e.g., Joseph V. Carcello, Chair, AAA Task Force to Monitor the Activities of the Treasury ACAP, Professor and Director of Research—Corporate Governance Center, University of Tennessee, Jean C. Bedard, Professor of Accountancy, Bentley College, and Dana R. Hermanson, Chair of Private Enterprise and Professor of Accounting, Kennesaw State University, Comment Letter Regarding Draft Report and Draft Report Addendum 2 (May 15, 2008), available at http://comments.treas.gov/_files/ACAPCommentLetterMay152008.pdf (recommending that auditing firms and regulators assist academic researchers with access to data relating to the auditing practice); Deloitte LLP, Comment Letter Regarding Draft Report and Draft Report Addendum 11–12 (June 27, 2008), available at http://comments.treas.gov/_files/DeloitteLLPCommentLetter.pdf (noting the attempt to actively work with academia to find ways to overcome confidentiality issues concerning auditing practice data); Record of Proceedings (June 3, 2008) (Written Submission of Kayla J. Gillan, Chief Administrative Officer, RiskMetrics Group, 2), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Gillan060308.pdf> (recommending that everyone have access to PCAOB inspection data and suggesting the Committee seek legislative amendments to allow this access); Record of Proceedings (June 3, 2008) (Written Submission of William Kinney, Charles & Elizabeth Prothro Regents Chair in Business and Price Waterhouse Fellow in Auditing, University of Texas, Austin, 5), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Kinney060308.pdf> (suggesting legislation encouraging access to data).

⁹⁹ See Record of Proceedings (Feb. 4, 2008) (Written Submission of Cynthia Fornelli, Executive Director, Center for Audit Quality, 2), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Fornelli020408.pdf> (stating that “[b]ecause of the profession’s concern over the shortage of qualified faculty to teach accounting, the AICPA Foundation, along with the 80 largest CPA firms, are working to raise more than \$17 million to fund additional PhD candidates at participating universities”).

¹⁰⁰ See, e.g., Record of Proceedings (Dec. 3, 2007) (Written Submission of Joseph V. Carcello, Director of Research, Corporate Governance, University of Tennessee, Knoxville, 21), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Carcello120307.pdf> (“[D]octoral students in * * * [a 2007] Deloitte [Foundation] study indicated that lack of access to public accounting firm and client data represented a severe obstacle to the research they want to conduct, and that this difficulty might result in them focusing on a different accounting sub-area. This issue must be addressed, or auditing may cease to exist as a discipline on many university campuses.”); Record of Proceedings (Feb. 4, 2008) (Written Submission of Phillip M.J. Reckers, Professor of Accountancy, Arizona State University, 8), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Reckers020408.pdf> (recommending the development of a means “for researchers to gain access to auditing related data” and noting, without this means, interest in doctoral auditing programs will continue to decline); Record of Proceedings (Dec. 3, 2007) (Written Submission of Ira Solomon, R.C. Evans Distinguished Professor, and Head, Department of Accountancy, University of Illinois, 7), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Solomon120307.pdf> (noting the lack of auditing research data and the “drastic decline in auditing research among extant accountancy faculty and among accountancy doctoral students”).

comments.treas.gov/_files/

[DeloitteLLPCommentLetter.pdf](http://comments.treas.gov/_files/DeloitteLLPCommentLetter.pdf) (noting the formation of a task force on cross-sabbaticals with accounting faculty, including those at HBCUs); Record of Proceedings (June 3, 2008) (Written Submission of William Kinney, Charles & Elizabeth Prothro Regents Chair in Business and Price Waterhouse Fellow in Auditing, University of Texas, Austin, 5), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Kinney060308.pdf> (supporting the idea of allowing professors to take sabbaticals and providing direct evidence by describing a recent assignment as an academic fellow in the Professional Practice Group of the SEC’s Office of Chief Accountant).

⁹⁸ See Joseph V. Carcello, Chair, AAA Task Force to Monitor the Activities of the Treasury ACAP, Professor and Director of Research—Corporate Governance Center, University of Tennessee, Jean C. Bedard, Professor of Accountancy, Bentley College, and Dana R. Hermanson, Chair of Private Enterprise and Professor of Accounting, Kennesaw State University, Comment Letter Regarding Draft Report and Draft Report Addendum 4 (May 15, 2008), available at http://comments.treas.gov/_files/ACAPCommentLetterMay152008.pdf (noting the need to “[p]lace equal emphasis on completing a sabbatical with a private sector institution or government entity as with publishing one ‘tier A’ paper”).

provide the necessary impetus to private sector institutions to help increase the number of accounting faculty as well as faculty with significant practical experience.

Recommendation 4. Develop and maintain consistent demographic and higher education program profile data.

The Committee heard testimony regarding the lack of consistent demographic and higher education program profile data concerning the profession.¹⁰⁴ The need for comparable, consistent, periodic information regarding the demographic profile of professional accountants and auditors, related higher education program capacity, entry-level supply and demand of personnel, accounting firm retention and compensation practices, and similar particulars are fundamental to a meaningful understanding of the human capital circumstances impacting the public company auditing profession and its future and sustainability.

Historically, there has been neither an ongoing collection of data nor a centralized location where the general public can access data. For instance, the AICPA publishes a supply and demand study every two years. Additionally, various other groups, such as the AAA, the National Association of State Boards of Accountancy, colleges and universities, and individuals collect some of these data but not in a manner available and useful for research.

Materials such as those supplied by the Center for Audit Quality to the Committee,¹⁰⁵ previous AICPA Supply and Demand studies,¹⁰⁶ and AAA-

commissioned demographic research¹⁰⁷ provide examples of the necessary information. In addition, AICPA membership trends, augmented by data available from state boards of accountancy regarding numbers of licensees, may be useful data.

Therefore, the Committee recommends the establishment of a national cooperative committee, comprised of organizations such as the AICPA and the AAA, to encourage periodic consistent demographic and higher education program profile data.¹⁰⁸ The Committee believes that having such data available will increase the ability of auditing firms, corporations, investors, academics, policy makers, and others to understand more fully, monitor and evaluate, and take necessary or desirable actions with respect to the human capital in the auditing profession and its future and sustainability.

Recommendation 5. Encourage the AICPA and the AAA to jointly form a commission to provide a timely study of the possible future of the higher education structure for the accounting profession.

The Committee heard testimony regarding the feasibility of establishing a free-standing, post-graduate professional educational structure.¹⁰⁹

Accounting Graduates and the Demand for Public Accounting Recruits (2008), available at http://ceae.aicpa.org/NR/rdonlyres/C1E23302-17D3-4ED5-AE81-B274D9CD7812/0/AICPA_Trends_Reports_2008.pdf.

¹⁰⁷ David Leslie, Accounting Faculty in U.S. Colleges and Universities: Status and Trends, 1993–2004, A Report of the American Accounting Association (Feb. 19, 2008).

¹⁰⁸ See, e.g., Joseph V. Carcello, Chair, AAA Task Force to Monitor the Activities of the Treasury ACAP, Professor and Director of Research—Corporate Governance Center, University of Tennessee, Jean C. Bedard, Professor of Accountancy, Bentley College, and Dana R. Hermanson, Chair of Private Enterprise and Professor of Accounting, Kennesaw State University, Comment Letter Regarding Draft Report and Draft Report Addendum 2 (May 15, 2008), available at http://comments.treas.gov/_files/ACAPCommentLetterMay152008.pdf (supporting this Recommendation); Ernst & Young LLP, Comment Letter Regarding Draft Report and Draft Report Addendum 23 (June 27, 2008), available at http://comments.treas.gov/_files/EYACAPCommentLetterFINAL2.pdf (supporting this Recommendation); Record of Proceedings (June 3, 2008) (Written Submission of Anne M. Lang, Chief Human Resources Officer, Grant Thornton LLP, 4), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Lang060308.pdf> (supporting this Recommendation).

¹⁰⁹ See, e.g., Record of Proceedings (Dec. 3, 2007) (Oral Submission of Joseph V. Carcello, Director of Research, Corporate Governance, University of Tennessee, Knoxville, 3), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/CarcelloOralStatement120307.pdf> (recommending that “the Advisory Committee consider a different model—an education model involving professional

Currently, there is no post-graduate institutional arrangement dedicated to accounting and auditing. Graduate programs in accounting are generally housed within business schools and linked with undergraduate accounting programs.

The history of the development of U.S. educational programs and preparation for accounting careers reveals a pattern of evolution of increasing formal higher education, with accreditation standards following and reinforcing this evolution, and with market needs providing the impetus and context. Today, accrediting agencies have recognized over 150 accounting programs as the result of these programs’ improving accounting education as envisioned by prior studies and reports.

In a November 2006 Vision Statement, the chief executive officers of the principal international auditing networks noted the challenges in educating future auditing professionals, including the sheer quantity and complexity of accounting and auditing standards, rapid technological advancements, and the need for specialized industry knowledge.¹¹⁰ This development in the market leads to a clear need to anticipate and enhance the human capital elements of the auditing profession. As such, this vision statement provides the impetus to commission a group to study and propose a long-term institutional arrangement for accounting and auditing education.

As in the past, in the face of challenges of the changing environment for the profession, the Committee believes that the educational system should thoughtfully consider the feasibility of a visionary educational model. Therefore, the Committee recommends that the AICPA and the AAA jointly form a body to provide a timely study of the possible future of the higher education structure for the

schools of auditing * * *’); Record of Proceedings (June 3, 2008) (Written Submission of Anne M. Lang, Chief Human Resources Officer, Grant Thornton LLP, 5), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Lang060308.pdf> (noting that the establishment of a commission to study a higher education structure for the accounting profession “is a very sound” recommendation). But, c.f., Record of Proceedings (Feb. 4, 2008) (Written Submission of Phillip M.J. Reckers, Professor of Accountancy, Arizona State University, 3), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Reckers020408.pdf> (discounting the feasibility of free-standing professional schools).

¹¹⁰ Global Capital Markets and the Global Economy: A Vision From the CEOs of the International Audit Networks 15 (Nov. 2006).

¹⁰⁴ See, e.g., Record of Proceedings (Dec. 3, 2007) (Questions for the Record of David A. Costello, President and Chief Executive Officer, NASBA, 2–4 (Feb. 6, 2008)), available at <http://www.treas.gov/offices/domestic-finance/acap/QFRs-12-3-07.pdf> (stating that “[s]ince 1970, * * * NASBA and the AICPA have recognized the need for a national database for Certified Public Accountants and have taken steps leading to the development of the database * * * [c]urrently, NASBA is not aware of a mechanism or database which would provide an accurate count of CPAs, without the effect of ‘double counting’”); Julia Grant, Demographic Challenges Facing the CPA Profession, 20 Research in Accounting Regulation (2008); Record of Proceedings (Dec. 3, 2007) (Written Submission of Ira Solomon, R.C. Evans Distinguished Professor, and Head, Department of Accountancy, University of Illinois, 13), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Solomon120307.pdf> (noting the lack of comprehensive accounting profession supply and demand data and recommending the “establishment of a continuous and comprehensive system that produces more timely and reliable supply and demand data”).

¹⁰⁵ Center for Audit Quality, Report of the Major Public Company Audit Firms to the Department of the Treasury Advisory Committee on the Auditing Profession (Jan. 23, 2008), available at <http://www.theacq.org/publicpolicy/data/TRData2008-01-23-FullReport.pdf>.

¹⁰⁶ Dennis R. Reigle, Heather L. Bunning and Danielle Grant, 2008 Trends in the Supply of

accounting profession.¹¹¹ This commission may include representation from higher education, practitioners from the wide spectrum of the accounting and auditing profession, regulators, preparers, users of the profession's services, and others. The commission would consider the potential role of a postgraduate professional school model to enhance the quality and sustainability of a vibrant accounting and auditing profession. The commission should consider developments in accounting standards and their application, auditing needs, regulatory framework, globalization, the international pool of candidates, and technology. Finally, a blueprint for this sort of enhanced professional educational structure would also require the consideration of long-term market circumstances, academic governance, operations, programs, funding and resources, the role of accreditation, and experiential learning processes.

V. Firm Structure and Finances

In addressing the sustainability of the auditing profession, the Committee sought input on and considered a number of matters relating directly to auditing firms, including audit quality, governance, transparency, global organization, financial strength, ability to access capital, the investing public's

¹¹¹ See, e.g., Joseph V. Carcello, Chair, AAA Task Force to Monitor the Activities of the Treasury ACAP, Professor and Director of Research—Corporate Governance Center, University of Tennessee, Jean C. Bedard, Professor of Accountancy, Bentley College, and Dana R. Hermanson, Chair of Private Enterprise and Professor of Accounting, Kennesaw State University, Comment Letter Regarding Draft Report and Draft Report Addendum 5 (May 15, 2008), available at http://comments.treas.gov/_files/ACAPCommentLetterMay152008.pdf (supporting this Recommendation and noting the need for these schools to be well-funded and be independent from business schools with control over tenure and promotion); Deloitte LLP, Comment Letter Regarding Draft Report and Draft Report Addendum 23 (June 27, 2008), available at http://comments.treas.gov/_files/DeloitteLLPCommentLetter.pdf (supporting this Recommendation and noting the commission should consider other human capital issues including financial and time concerns as well as recruiting individuals from other disciplines); Record of Proceedings (June 3, 2008) (Written Submission of Anne M. Lang, Chief Human Resources Officer, Grant Thornton LLP, 5), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Lang060308.pdf> (agreeing with this Recommendation). But, c.f., Record of Proceedings (June 3, 2008) (Written Submission of Frank K. Ross, Director, Center for Accounting Education, Howard University School of Business, 11), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Ross060308.pdf> (noting the financial concerns that an extra year of schooling would have on the less affluent, which includes a “disproportionate number” of minorities).

understanding of auditors' responsibilities and communications, the limitations of audits, particularly relating to fraud detection and prevention, as well as the effect of litigation where audits are alleged to have been ineffective. The Committee also considered the regulatory system applicable to auditing firms.

While much data was available to the Committee, such information was not exhaustive. Certain information regarding auditors of public companies, the auditor of record, and audit fees is readily available. Auditing firms also provide on a voluntarily basis certain other information they believe useful to clients, regulators, and/or investors. Also, in connection with the work of the Committee, the largest firms provided certain additional input, through the Center for Audit Quality (CAQ), sometimes by individual firm and sometimes in summarized format.¹¹²

After reviewing these data and receiving testimony from witnesses and comment letters, the Committee focused on a few specific areas: Fraud prevention and detection; federal and state regulatory system; governance; and disclosure of auditor changes.

The Committee recommends that regulators, the auditing profession, and others, as applicable, effectuate the following:

Recommendation 1. Urge the [] to create a national center to facilitate auditing firms' and other market participants' sharing of fraud prevention and detection experiences, practices, and data and innovation in fraud prevention and detection methodologies and technologies, and commission research and other fact-finding regarding fraud prevention and detection, and further, the development of best practices regarding fraud prevention and detection.

Public Company Accounting Oversight Board (PCAOB) standards currently require auditors to plan and perform audits to obtain reasonable assurance whether financial statements are free of material misstatement, including those caused by fraud.¹¹³ The Committee considered testimony and commentary regarding auditing firms' responsibilities and practices relating to

¹¹² Center for Audit Quality, Report of the Major Public Company Audit Firms to the Department of the Treasury Advisory Committee on the Auditing Profession (Jan. 23, 2008); Center for Audit Quality, Second Supplement to Report of the Major Public Company Audit Firms to the Department of the Treasury Advisory Committee on the Auditing Profession (Apr. 16, 2008).

¹¹³ Consideration of Fraud in a Financial Statement, Interim Auditing Standard AU 316 (Pub. Company Accounting Oversight Bd. 2002).

fraud prevention and detection.¹¹⁴ The auditing profession itself has recognized the significance of its duties with respect to fraud: “Perhaps no single issue is the subject of more confusion, yet is more important, than the nature of the obligation of auditors to detect fraud—or intentional material misstatement of financial information by public companies.”¹¹⁵

No formal forum currently exists where auditors and other market participants regularly share their views and experiences relating to fraud prevention and detection in the context of fraudulent financial reporting. The Committee received testimony that it would improve audit quality and benefit the capital markets and investors and other financial statement users for auditing firms to share their fraud detection experiences¹¹⁶ and to develop best practices relating to fraud prevention and detection.¹¹⁷

The Committee believes that a collective sharing of fraud prevention and detection experiences among auditors and other market participants will provide a broad view of auditor practices and ultimately improve fraud prevention and detection capabilities and enable the development of best practices. The Committee also believes that research into industry trends and statistics will help auditors focus and develop procedures to identify areas

¹¹⁴ See, e.g., Andrew D. Bailey, Jr., Professor of Accountancy-Emeritus, University of Illinois, and Senior Policy Advisor, Grant Thornton LLP, Comment Letter Regarding Discussion Outline 4 (Jan. 30, 2008), available at http://comments.treas.gov/_files/BAILEYCOMMENTSONTREASURYADVISORYCOMMITTEEOUTLINEFINALSUBMISSION13008.doc; Record of Proceedings (Feb. 4, 2008) (Written Submission of Dennis Johnson, Senior Portfolio Manager, Corporate Governance, California Public Employees' Retirement System, 5), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Johnson020408.pdf>.

¹¹⁵ Serving Global Capital Markets and the Global Economy: A View from the CEOs of the International Audit Networks 12 (Nov. 2006).

¹¹⁶ See, Record of Proceedings (Feb. 4, 2008) (Questions for the Record of Cynthia M. Fornelli, Executive Director, Center for Audit Quality, 6 (Mar. 31, 2008)), available at <http://www.treas.gov/offices/domestic-finance/acap/agendas/-QFRs-2-4-08.pdf>; Record of Proceedings (Dec. 3, 2007) (Written Submission of James S. Turley, Chairman and Chief Executive Officer, Ernst & Young LLP, 7), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Turley120307.pdf>.

¹¹⁷ See, e.g., Record of Proceedings (Feb. 4, 2008) (Written Submission of Edward E. Nusbaum, Chief Executive Officer, Grant Thornton LLP, and Chairman, Grant Thornton International Board of Governors, 10), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Nusbaum020408.pdf> (stating that “[s]uccess also requires that the profession work with standard setters and regulators to develop best practices and the infrastructure for effective audits designed to detect material financial fraud”).

and situations at greater risk for fraud. The Committee believes that best practices regarding fraud prevention and detection will enhance the processes and procedures of auditing firms.

The Committee recommends that the [] create a national center both to facilitate auditing firms' sharing of fraud prevention and detection experiences, practices, and data and innovation in fraud prevention and detection methodologies and technologies and to commission research and other fact-finding regarding fraud prevention and detection.¹¹⁸ The Committee also recommends that the auditing firms, forensic accounting firms, certified fraud examiners, investors, other financial statement users, public companies, and academics develop, in consultation with the PCAOB, the Securities and Exchange Commission (SEC), international regulators, and the National Association of State Boards of Accountancy (NASBA), best practices regarding fraud prevention and detection.¹¹⁹ The Committee also

¹¹⁸ See, e.g., Joseph Carcello, Chair, AAA Task Force to Monitor the Activities of the Treasury ACAP Ernst & Young Professor and Director of Research—Corporate Governance Center University of Tennessee, Jean C. Bedard Timothy B. Harbert Professor of Accountancy Bentley College, Dana R. Hermanson Dinos Eminent Scholar Chair of Private Enterprise and Professor of Accounting Kennesaw State University, Comment Letter Regarding Draft Report and Draft Report Addendum 6, (May 15, 2008), available at http://comments.treas.gov/_files/ACAPCommentLetterMay152008.pdf (supporting this Recommendation); Samuel K. Cotterell, Chair, NASBA, and David A. Costello, President and CEO, NASBA, Comment Letter Regarding Draft Report and Draft Report Addendum 2, (June 27, 2008), available at http://comments.treas.gov/_files/June2908LetterheadTreasuryAdvisoryCommitteeontheAuditingProfession.pdf (“Conclusions from, or approaches discussed during, Center deliberations could have an immediate effect on the way accounting practitioners approach the performance of audits and would likely form the basis for consideration of changes in auditing standards.”); Record of Proceedings (June 3, 2008) (Written Submission of Kenneth Nielsen Goldmann, Capital Markets and SEC Practice Director, J.H. Cohn LLP, 5), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Goldmann060308.pdf> (noting how useful such a center would be to smaller firm auditors in detecting and preventing fraud.); Cynthia Fornelli, Executive Director, Center for Audit Quality, Comment Letter Regarding Draft Report and Draft Report Addendum 10–11, (June 26, 2008), available at http://comments.treas.gov/_files/CAQCommentLetter62708FINAL.pdf (agreeing with this Recommendation and volunteering the Center for Audit Quality to house this center). But c.f., Jim Wanserski, Businessman, Comment Letter Regarding Draft Report and Draft Report Addendum (June 3, 2008), available at http://comments.treas.gov/_files/ACAPDraftReportCommentsJune22008.doc (stating that public company management is key in fraud prevention and detection efforts more so than the external auditor and notes the small percentage of frauds uncovered by public company auditors).

¹¹⁹ See Dave Richards, Institute of Internal Auditors, Comment Letter Regarding Draft Report

recognizes that a national center and best practices will have greater impact if these concepts are ultimately extended and embraced internationally.

Recommendation 2. Encourage greater regulatory cooperation and oversight of the public company auditing profession to improve the quality of the audit process and enhance confidence in the auditing profession and financial reporting.

The SEC, the PCAOB, and individual state boards of accountancy regulate the auditing profession. The SEC and the PCAOB enforce the securities laws and regulations addressing public company audits. Individual state accountancy laws in fifty-five jurisdictions in the United States govern the licensing and regulation of both individuals and firms who practice as certified public accountants.¹²⁰ State boards of accountancy enforce these laws and also administer the Uniform CPA Examination. NASBA serves as a forum for these boards to enhance their regulatory effectiveness and communication.

The Committee believes that enhancing regulatory cooperation and reducing duplicative oversight of the auditing profession by federal and state authorities and enhancing licensee practice mobility among the states are in the best interest of the public and the effective operation of the capital markets. In this regard, the Committee recommends the following:

(a) Institute the following mechanism to encourage the states to substantially adopt the mobility provisions of the Uniform Accountancy Act, Fifth Edition (UAA)¹²¹: If states have failed to adopt the mobility provisions of the UAA by December 31, 2010, Congress should pass a federal provision requiring those states to adopt these provisions.

The American Institute of Certified Public Accountants (AICPA) and NASBA jointly author the UAA, a model bill which focuses on the education, examination, and experience requirements for certified public accountants. As the name of the bill suggests, the UAA advances the goal of uniformity, in addition to protecting the

and Draft Report Addendum 3, (June 13, 2008), available at http://comments.treas.gov/_files/ILARESRESPONSETREASURYADVISORYCOMMITTEEONAUDITING061308.doc (suggesting the Institute of Internal Auditors be included in the listing of organizations providing best practices).

¹²⁰ Record of Proceedings (Dec. 3, 2007) (Written Submission of David A. Costello, President and Chief Executive Officer, National Association of State Board of Accountancy, 2), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Costello120307.pdf>.

¹²¹ Uniform Accountancy Act (*Fifth Ed. July 2007*).

public interest and promoting high professional standards. In 2006 and 2007, recognizing the changing global economy and the impact of electronic commerce, the AICPA and NASBA proposed amendments to the UAA to allow for a streamlined framework for CPA “mobility” of practice among the states; that is, a CPA’s practice privileges would be valid and portable across all state jurisdictions beyond that of the CPA’s resident state.¹²²

According to NASBA, to date thirty-one states have passed mobility legislation. Two other states currently have mobility legislation introduced and other bills are anticipated in the 2009 legislative session. Almost every state is now discussing or considering mobility, and a number of other state boards of accountancy have voted to support and move forward with mobility.

The Committee considered testimony and commentary on the importance to auditing firms’ multi-state practices of the adoption of the UAA’s mobility provisions.¹²³ A NASBA representative testified, “In order for our capital market system to continue to prosper and grow, NASBA recognized the need to ensure that an efficient, effective mobility system is in place that will allow CPAs and their firms, as professional service providers, to serve

¹²² See Record of Proceedings (Dec. 3, 2007) (Questions for the Record of David A. Costello, President and Chief Executive Officer, National Association of State Board of Accountancy, 1 (Feb. 6, 2008)), available at <http://www.treas.gov/offices/domestic-finance/acap/QFRs-12-3-2007.pdf> (“As the global business community continues to expand, CPAs will be required to practice beyond the state in which they reside. Inefficiencies are created when those individuals are required to complete paperwork and submit a fee for every state in which they perform professional services.”). Note that the UAA does require notification or “permitting” for out-of-state firms performing attest services for audit clients headquartered in another state, but not for individual CPAs. See UAA, §§ 7(a)(1), 7(c)(1), and 23(a)(4) (Fifth Ed. July 2007).

¹²³ See, e.g., Amper, Politziner and Mattia, P.C., Comment Letter Regarding Discussion Outline 2 (Nov. 14, 2007) available at http://comments.treas.gov/_files/AmperPolitzinerMattia.pdf (noting that “[t]he ease of performing audits in any state by a valid CPA * * * without requiring to be licensed by each state would be beneficial.”); Record of Proceedings (Dec. 3, 2007) (Written Submission of Dennis Nally, Chairman and Senior Partner, PricewaterhouseCoopers LLP, 5) (Dec. 3, 2008), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Nally120307.pdf> (noting that a number of states are cooperating and working towards adopting uniform mobility requirements); Record of Proceedings (Dec. 3, 2007) (Written Submission of James S. Turley, Chairman and Chief Executive Officer, Ernst & Young LLP, 5), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Turley120307.pdf> (“The Treasury Committee should suggest that the states eliminate barriers to interstate practice by universal adoption of the mobility provisions of the Uniform Accountancy Act.”).

the needs of American businesses, where ever they are located.”¹²⁴

The Committee believes that, given the multi-state operations of many public companies and the multi-state practices of many auditing firms, practice mobility will foster a more efficient operation of the capital markets. The Committee recommends the following mechanism to encourage the states to adopt the UAA's mobility provisions: If states have failed to adopt the mobility provisions of the UAA by December 31, 2010, Congress should pass a federal provision requiring those states to adopt these provisions.¹²⁵ The Committee recognizes that some state legislatures meet biannually, and for such legislatures this deadline poses a challenge.¹²⁶ However, such a deadline

¹²⁴ Record of Proceedings (Dec. 3, 2007) (Written Submission of David A. Costello, President and Chief Executive Officer, National Association of State Board of Accountancy, 6), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Costello120307.pdf>.

¹²⁵ See, e.g., Ernst & Young LLP, Comment Letter Regarding Draft Report and Draft Report Addendum 24–25, (June 27, 2008), available at http://comments.treas.gov/_files/EYACAPCommentLetterFINAL.pdf (agreeing with this Recommendation); Mayer Hoffman McCann P.C., Comment Letter Regarding Draft Report and Draft Report Addendum 2, (June 17, 2008), available at http://comments.treas.gov/_files/MayerHoffmanMcCannCommentLetter.pdf (noting that the lack of mobility impairs firms from assigning the best people to engagements and uses important resources to establish and comply with multiple state licensure); PricewaterhouseCoopers, Comment Letter Regarding Draft Report and Draft Report Addendum 9, (June 30, 2008), available at http://comments.treas.gov/_files/PwCCommentLtrTreasCmtDraftandAddendum63008.pdf; Bruce Rosen, Eisner LLP, Comment Letter Regarding Draft Report and Draft Report Addendum (May 23, 2008), available at http://comments.treas.gov/index.cfm?FuseAction=Home.View&Topic_id=9&FellowType_id=1&CurrentPage=1 (noting the importance of putting the right resources in the right place without the needless complexity of differing state requirements). But c.f., Joseph Carcello, Chair, AAA Task Force to Monitor the Activities of the Treasury ACAP Ernst & Young Professor and Director of Research, Corporate Governance Center University of Tennessee, Jean C. Bedard Timothy B. Harbert Professor of Accountancy Bentley College, Dana R. Hermanson Dinos Eminent Scholar Chair of Private Enterprise and Professor of Accounting Kennesaw State University, Comment Letter Regarding Draft Report and Draft Report Addendum 6, (May 15, 2008), available at http://comments.treas.gov/_files/ACAPCommentLetterMay152008.pdf (recommending that while there does need to be increased mobility, it could be achieved by a national license for public company audits in addition to state licensing.); William Hermann, Managing Partner, and Gregory Coursen, Director of Professional Standards, Plante & Moran, PLLC Comment Letter Regarding Draft Report and Draft Report Addendum 2, (June 12, 2008), available at http://comments.treas.gov/_files/CommentLetter61208.pdf (noting the AICPA's success in driving the adoption of the UAA's mobility provision).

¹²⁶ See, e.g., Samuel K. Cotterell, Chair, NASBA, and David A. Costello, President and CEO, NASBA, Comment Letter Regarding Draft Report and Draft Report Addendum 3, (June 27, 2008), available at

should be attainable and will encourage such legislatures to place this issue high on their agenda. The Committee also recommends that the states participate in NASBA's Accountancy Licensee Database (ALD) as a mechanism to assist in maintaining appropriate oversight of CPAs throughout the country regardless of where they practice and that appropriate authorities interpret federal and state privacy regulations to facilitate implementation of the ALD.

(b) Require regular and formal roundtable meetings of regulators and other governmental enforcement bodies in a cooperative effort to improve regulatory effectiveness and reduce the incidence of duplicative and potentially inconsistent enforcement regimes.

Under the federal securities laws, the SEC has enforcement authority over public company auditing firms and oversight authority over the PCAOB under the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley). Sarbanes-Oxley provides the PCAOB with registration, reporting, inspection, standard-setting, and enforcement authority over public company auditing firms.¹²⁷ In addition, the fifty-five boards of accountancy license, regulate, and enforce state accountancy laws pertaining to certified public accountants and their firms. In addition, the Department of Justice (DOJ) and state attorneys general can bring enforcement actions against auditing firms and their employees.

The Committee considered testimony from auditing firms on the duplicative and sometimes inconsistent federal and state oversight of the profession.¹²⁸ The

http://comments.treas.gov/_files/June2908LetterheadTreasuryAdvisoryCommitteeontheAuditingProfession.pdf (recommending a later due date because some states may not be able to meet the 2010 deadline due to their legislative calendars); Cynthia Fornelli, Executive Director, Center for Audit Quality, Comment Letter Regarding Draft Report and Draft Report Addendum 14–15, (June 26, 2008), available at http://comments.treas.gov/_files/CAQCommentletter62708FINAL.pdf (suggesting delaying federal action as states may adopt the provisions on their own or, at the least, moving the deadline to December 31, 2011 to allow states adequate time to adopt the provisions).

¹²⁷ Sarbanes-Oxley Act of 2002, 15 U.S.C. §§ 7211–7219.

¹²⁸ See, e.g., Record of Proceedings (Dec. 3, 2007) (Written Submission of Dennis Nally, Chairman and Senior Partner, PricewaterhouseCoopers LLP, 5), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Nally120307.pdf>; Record of Proceedings (Feb. 4, 2008) (Written Submission of Edward E. Nusbaum, Chief Executive Officer, Grant Thornton LLP, and Chairman, Grant Thornton International Board of Governors, 7), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Nusbaum020408.pdf>; Record of Proceedings (Feb. 4, 2008) (Questions for the Record of Barry Salzberg, Chief Executive Officer, Deloitte LLP, App. A 4 (Mar. 31, 2008)), available at <http://www.treas.gov/offices/domestic-finance/>

Committee does recognize that both federal and state regulators have made attempts to coordinate better their enforcement activities.¹²⁹ One witness suggested the possible formation of a commission to help improve regulatory effectiveness.¹³⁰ Another witness urged state and federal regulatory cooperation to ensure harmonized regulation and licensure.¹³¹

The Committee recommends mandating regular and formal roundtables of the PCAOB, the SEC, the DOJ, the state boards of accountancy, and the state attorneys general, to periodically review the overall enforcement regimes applicable to the public company auditing profession.¹³²

[acap/agendas/QFRs-2-4-08.pdf](http://www.treas.gov/offices/domestic-finance/acap/agendas/QFRs-2-4-08.pdf) (criticizing duplicative auditing firm investigations by states with no nexus to alleged conduct).

¹²⁹ See, e.g., Record of Proceedings (Dec. 3, 2007) (Oral Remarks of David A. Costello, President and Chief Executive Officer, National Association of State Board of Accountancy, 98), available at <http://www.treas.gov/offices/domestic-finance/acap/agendas/minutes-12-3-07.pdf> (noting that “[NASBA] has been working with the PCAOB very closely coordinating efforts, trying to diminish as much as possible the redundancy in enforcement”) Record of Proceedings (Dec. 3, 2007) (Written Submission of David A. Costello, President and Chief Executive Officer, National Association of State Board of Accountancy, 6), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Costello120307.pdf> (stating that NASBA is assisting state boards in enforcement cases involving multi-state activities).

¹³⁰ Record of Proceedings (Feb. 4, 2008) (Written Submission of Edward E. Nusbaum, Chief Executive Officer, Grant Thornton LLP, and Chairman, Grant Thornton International Board of Governors, 7), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Nusbaum020408.pdf> (noting that, “it would be useful to evaluate the possibility of an interstate commission for the whole of the audit profession. Such a commission would bring together state licensing authorities, the PCAOB, and appropriate professional organizations. It would be the means to rationalize existing disparities in licensing qualifications, continuing education requirements and peer review for non-public company audit practices. It would also enable enforcement of common regulations and license discipline across state and federal jurisdictions.”).

¹³¹ Record of Proceedings (Dec. 3, 2007) (Written Submission of Dennis Nally, Chairman and Senior Partner, PricewaterhouseCoopers LLP, 5), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Nally120307.pdf>.

¹³² See e.g., Joseph Carcello, Chair, AAA Task Force to Monitor the Activities of the Treasury ACAP Ernst & Young Professor and Director of Research—Corporate Governance Center University of Tennessee, Jean C. Bedard Timothy B. Harbert Professor of Accountancy Bentley College, Dana R. Hermanson Dinos Eminent Scholar Chair of Private Enterprise and Professor of Accounting Kennesaw State University, Comment Letter Regarding Draft Report and Draft Report Addendum 6, (May 15, 2008), available at http://comments.treas.gov/_files/ACAPCommentLetterMay152008.pdf (supporting this Recommendation); Samuel K. Cotterell, Chair, NASBA, and David A. Costello, President and CEO, NASBA, Comment Letter Regarding Draft Report and Draft Report Addendum 3, (June 27, 2008), available at http://comments.treas.gov/_files/June2908Letterhead

These roundtables also should focus on regulatory coordination, improvement, and consistent approaches to enforcement to minimize duplicative efforts. Because of the difficulty and cost of bringing together many different state agencies on a regular basis, the Committee recommends that NASBA assist states by taking a leadership role in coordinating their responsibilities and interests.¹³³

(c) Urge the states to create greater financial and operational independence of their state boards of accountancy.

The Committee is concerned about the financial and operational independence of state boards of accountancy from outside influences, such as other state agencies, and the possible effect on the regulation and oversight of the accounting profession. A number of state boards are underfunded¹³⁴ and lack the wherewithal to incur the cost of investigations leading to enforcement. In addition, some state boards fall under the centralized administrative “umbrella” of other state agencies and lack control of financial resources and/or operational independence necessary to carry out their mandate of public protection.¹³⁵ In some cases, board members are nominated by private associations whose constituencies are not necessarily focused on the protection of the public.

The Committee believes that greater independence of state boards of

accountancy would enhance their regulatory effectiveness. The Committee recommends that, working with NASBA, states evaluate and develop means to make their respective state boards of accountancy more operationally and financially independent of outside influences.¹³⁶ The Committee notes that this Recommendation to ensure the independence of state boards of accountancy is not meant to limit in any way the efforts of regulators and other governmental enforcement bodies to coordinate their regulatory and enforcement activities as recommended in Recommendation 2(b).

Recommendation 3. Urge the PCAOB and the SEC, in consultation with other federal and state regulators, auditing firms, investors, other financial statement users, and public companies, to analyze, explore, and enable, as appropriate, the possibility and feasibility of firms appointing independent members with full voting power to firm boards and/or advisory boards with meaningful governance responsibilities to improve governance and transparency of auditing firms.

In response to the recent corporate accounting scandals, related legislative and regulatory requirements and best practices, public companies enhanced their corporate governance. One of the most prominent alterations to the corporate governance scheme was the increased representation and strengthening of independent members of boards of directors. The New York Stock Exchange and the Nasdaq enhanced their public company listing standards to call for a majority of independent board members.¹³⁷ Best practices have gone even further, calling for a “substantial majority” of independent directors.¹³⁸

¹³⁶ See Samuel K. Cotterell, Chair, NASBA, and David A. Costello, President and CEO, NASBA, Comment Letter Regarding Draft Report and Draft Report Addendum 3, (June 27, 2008), available at http://comments.treas.gov/_files/June2908LetterheadTreasuryAdvisoryCommitteeontheAuditingProfession.pdf (“There is a need to ensure all State Boards of Accountancy have adequate funding to maintain a healthy regulatory environment, which includes the ability to fund the costs of investigations and disciplinary enforcement.”); Ernst & Young LLP Comment Letter Regarding Draft Report and Draft Report Addendum 25, (June 27, 2008), available at http://comments.treas.gov/_files/EYACAPCommentLetterFINAL.pdf (agreeing that appropriate operational support is needed to allow regulators the resources to monitor the profession).

¹³⁷ New York Stock Exchange, Listed Company Manual § 303A.01 (2003); Nasdaq, Manual, Rule 4350(c).

¹³⁸ See, e.g., The Business Roundtable, Principles of Corporate Governance (May 2002) (recommending, among other things, a substantial majority of independent directors and fully

A combination of Sarbanes-Oxley provisions and exchange listing standards mandate fully independent audit committees, nominating/corporate governance, and compensation committees.¹³⁹ In addition, independent directors’ responsibilities have increased. For example, the independent audit committee now appoints, oversees, and compensates the auditor.¹⁴⁰ Although difficult to quantify the benefits of these enhancements, many have extolled these reforms as improving the quality of board oversight, reducing conflicts of interest, and enhancing investor confidence in public company operations and financial reporting.¹⁴¹

Public company auditing firms as private partnerships are not subject to these requirements. Instead, state laws and partnership agreements determine the governance of auditing firms.¹⁴² Often a firm’s governing body is

independent audit, corporate governance/nominating, and compensation committees); The Conference Board, Commission on Public Trust and Private Enterprise (Jan. 9, 2003) (recommending, among other things, a substantial majority of independent directors and regular executive sessions of the independent directors).

¹³⁹ Sarbanes-Oxley Act, 15 U.S.C. § 78–j (2002) (mandating audit committees comprised solely of independent directors); New York Stock Exchange, Listed Company Manual § 303A.04 (2004) (requiring nominating/corporate governance committees comprised solely of independent directors); New York Stock Exchange, Listed Company Manual § 303A.05 (2004) (requiring compensation committees comprised solely of independent directors); New York Stock Exchange, Listed Company Manual § 303A.06 (2003) (mandating compliance with SEC rules requiring audit committees comprised solely of independent directors); Nasdaq, Manual, Rule 4350(d) (mandating compliance with SEC rules requiring audit committees comprised solely of independent directors). Nasdaq, Manual, Rule 4350(c)(3) (requiring independent directors to determine, or recommend to the full Board for determination, the compensation of all executive officers). Nasdaq, Manual, Rule 4350(c)(4) (requiring independent directors to determine, or recommend to the full Board for determination, director nominees.).

¹⁴⁰ Sarbanes-Oxley Act, 15 U.S.C. § 78–j (2002).

¹⁴¹ For example, see the commentary accompanying New York Stock Exchange, Listed Company Manual § 303A.01 (“Requiring a majority of independent directors will increase the quality of board oversight and lessen the possibility of damaging conflicts of interest.”) and the interpretive material accompanying Nasdaq Rule 4350, IM–4350–4 (“Independent directors * * * play an important role in assuring investor confidence. Through the exercise of independent judgment, they act on behalf of investors to maximize shareholder value in the companies they oversee and guard against conflicts of interest. Requiring that the board be comprised of a majority of independent directors empowers such directors to carry out more effectively these responsibilities.”).

¹⁴² Center for Audit Quality, Report of the Major Public Company Audit Firms to the Department of the Treasury Advisory Committee on the Auditing Profession 2 (Jan. 23, 2008).

TreasuryAdvisoryCommitteeontheAuditingProfession.pdf (supporting this Recommendation); Mayer Hoffman McCann P.C., Comment Letter Regarding Draft Report and Draft Report Addendum 2, (June 13, 2008), available at http://comments.treas.gov/_files/MayerHoffmanMcCannCommentLetter.pdf (suggesting that all meetings be made public); but, cf. Frank Frankowski, CFO, Airborne Systems, Comment Letter Regarding Draft Report and Draft Report Addendum 1, (June 2, 2008), available at http://comments.treas.gov/_files/FrankowskiLetter.pdf (stating that the Recommendation “will only add to the confusion and lack of focus on the underlying issues”).

¹³³ Samuel K. Cotterell, Chair, NASBA, and David A. Costello, President and CEO, NASBA, Comment Letter Regarding Draft Report and Draft Report Addendum 3, (June 27, 2008), available at http://comments.treas.gov/_files/June2908LetterheadTreasuryAdvisoryCommitteeontheAuditingProfession.pdf (supporting this Recommendation).

¹³⁴ National Association of State Boards of Accountancy, Submission in Connection With the December 3, 2007 Meeting of the Advisory Committee on the Auditing Profession (Jan. 2008) (documenting the wide spectrum of funding for individual state boards of accountancy and noting the number of full-time staff per state boards of accountancy office).

¹³⁵ Statement of Ronald J. Rotaru, Executive Director, Accountancy Board of Ohio, before Ohio H. Finance Committee of the Ohio House of Representatives 1 (Mar. 18, 2005) (“The evidence shows that ‘consolidated’ states have difficulty in effectively enforcing the statutes governing the profession under their central agency umbrella.”).

comprised of elected firm partners.¹⁴³ Some firms are currently using advisory boards, although these may not be well-publicized or transparent.

Several witnesses testified to the benefits of improving auditing firm governance and suggested the addition of independent members to the boards of directors.¹⁴⁴ One witness called for an entirely independent board with enhanced responsibilities, including chief executive officer selection, determining partner compensation, and monitoring potential conflicts of interest and audit quality.¹⁴⁵ An auditing firm representative noted that his firm was considering adding independent members on its international governing board.¹⁴⁶

The Committee believes that enhancing corporate governance of auditing firms through the appointment of independent board members, whose duties run to the auditing firm and its partners/owners, to advisory boards with meaningful governance responsibilities (possible under the

current business model), and/or to firm boards could be particularly beneficial to auditing firm management and governance.¹⁴⁷ The Committee also believes that such advisory boards and independent board members could improve investor protection through enhanced audit quality and firm transparency. The Committee is particularly intrigued by the idea of independent board members with duties and responsibilities similar to those of public company non-executive board members.

The Committee recognizes the multiple challenges that instituting a governance structure with independent board members might entail, including compliance with state partnership laws and independence requirements, insurance availability for such directors, and liability concerns.¹⁴⁸ Accordingly, the Committee recommends that the PCAOB and the SEC, in consultation with federal and state regulators, auditing firms, investors, other financial statement users, and public companies, analyze, explore, and enable, as appropriate, the possibility and feasibility of firms' appointing independent board members and advisory boards.¹⁴⁹ The Committee

notes that the PCAOB and the SEC should consider the size of auditing firms in analyzing and developing any governance proposals.¹⁵⁰

Recommendation 4. Urge the SEC to amend Form 8-K disclosure requirements to characterize appropriately and report every public company auditor change and to require auditing firms to notify the PCAOB of any premature engagement partner changes on public company audit clients.

In 2006, over 1,300 public companies changed their auditor and from 2002 to 2006 over 6,500 public companies changed their auditor.¹⁵¹ Under current SEC regulations, a public company must disclose any auditor change on Form 8-K.¹⁵² SEC regulations require disclosure of any disagreements on financial disclosures during the preceding two years prior to a resignation or termination and whether some issue, such as the auditor's inability to rely on management's representations, may put into question financial disclosure reliability. SEC regulations also allow a public company to request that the auditor respond with a letter addressed to the SEC stating whether it agrees with the company's disclosure and, if it does not agree, stating why.

While the SEC does attempt to uncover through its rules whether the auditor change relates to disagreements over accounting and reporting matters, the SEC rules do not require a public company to provide a reason for the auditor's departure in the vast majority of cases. The limitations of the existing disclosure requirements have resulted in companies failing to disclose any reason for their auditor changes in

¹⁴³ Center for Audit Quality, Report of the Major Public Company Audit Firms to the Department of the Treasury Advisory Committee on the Auditing Profession 2-22 (Jan. 23, 2008) (detailing the various governance structures of the largest six auditing firms); Cynthia M. Fornelli, Executive Director, Center for Audit Quality, and James S. Turley, Chair, Governing Board, Center for Audit Quality, and Chairman and CEO, Ernst & Young LLP, Comment Letter Regarding Discussion Outline 13 (Nov. 30, 2007), available at http://comments.treas.gov/_files/Treasurycommentletterfinal11302007.pdf (noting the largest auditing firms have supervisory boards overseeing management).

¹⁴⁴ See, e.g., Andrew D. Bailey, Jr., Professor of Accountancy-Emeritus, University of Illinois, and Senior Policy Advisory, Grant Thornton LLP, Comment Letter Regarding Discussion Outline 12 (Jan. 30, 2008), available at http://comments.treas.gov/_files/BAILEYCOMMENTSONTREASURYADVISORYCOMMITTEEOUTLINEFINALSUBMISSION13008 ("[I]ndependent board members similar to those found on public company boards would be a good governance practice and would signal the markets about the firms' positive commitment to the public good."); Record of Proceedings (Feb. 4, 2008) (Written Submission of Dennis Johnson, Senior Portfolio Manager, Corporate Governance, California Public Employees' Retirement System, 3), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Johnson020408.pdf> (stating that independent board of directors could possibly decrease potential conflicts of interest).

¹⁴⁵ Record of Proceedings (Feb. 4, 2008) (Written Submission of Paul G. Haaga Jr., Vice Chairman, Capital Research and Management Company, 2), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Haaga020408.pdf>.

¹⁴⁶ Record of Proceedings (Feb. 4, 2008) (Written Submission of Edward E. Nusbaum, Chief Executive Officer, Grant Thornton LLP, and Chairman, Grant Thornton International Board of Governors, 7), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Nusbaum020408.pdf>.

¹⁴⁷ Record of Proceedings (Feb. 4, 2008) (Written Submission of Edward E. Nusbaum, Chief Executive Officer, Grant Thornton LLP, and Chairman, Grant Thornton International Board of Governors, 7), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Nusbaum020408.pdf> ("Such a change in the governance model may be one way to strengthen our ability to serve market participants and reinforce independence.").

¹⁴⁸ Several witnesses commented on these difficulties. See, e.g., Ernst & Young LLP Comment Letter Regarding Draft Report and Draft Report Addendum 25-26, (June 27, 2008), available at http://comments.treas.gov/_files/EYACAPCommentLetterFINAL.pdf; Cynthia Fornelli, Executive Director, Center for Audit Quality, Comment Letter Regarding Draft Report and Draft Report Addendum 17-19, (June 26, 2008), available at http://comments.treas.gov/_files/CAQCommentletter62708FINAL.pdf; William Hermann, Managing Partner, and Gregory Coursen, Director of Professional Standards, Plante & Moran, PLLC Comment Letter Regarding Draft Report and Draft Report Addendum 1-2, (June 13, 2008), available at http://comments.treas.gov/_files/Commentletter61208.pdf; Record of Proceedings (June 3, 2008) (Written Submission of Barry Mathews, Deputy Chairman, Aon Corporation, 2), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Mathews060308.pdf>; David McDonnell, Chief Executive Officer, Grant Thornton International Ltd, and Edward E. Nusbaum, Chief Executive Officer, Grant Thornton LLP, and Chairman, Grant Thornton International Ltd Board of Governors, Comment Letter Regarding Draft Report and Draft Report Addendum 4 (June 27, 2008) available at http://comments.treas.gov/_files/GTCommentlettertoACAPJune2008_FINAL.pdf.

¹⁴⁹ See Record of Proceedings (June 3, 2008) (Written Submission of Nell Minow, Editor and Co-Founder, The Corporate Library, 2), available at <http://www.treas.gov/offices/domestic-finance/>

<http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Minow060308.pdf>. But, cf. Wayne Kolins, Director of Assurance, BDO Seidman LLP, Comment Letter Regarding Draft Report and Draft Report Addendum 3-4, (June 27, 2008) available at http://comments.treas.gov/_files/ResponsetoAdvisoryCommittee0627final.PDF (advising the Committee to keep in mind the fact that accounting firms operate differently than public companies and that the PCAOB currently reviews information that would concern independent board members); Paul Lee, Director, Hermes Equity Ownership Services Limited, Comment Letter Regarding Draft Report and Draft Report Addendum 3, (June 13, 2008), available at http://comments.treas.gov/_files/ACAPResponse13Jun08.pdf.

¹⁵⁰ See Record of Proceedings (June 3, 2008) (Written Submission of Kenneth Nielsen Goldmann, Capital Markets and SEC Practice Director, J.H. Cohn LLP, 4-5), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Goldmann060308.pdf> (noting that smaller firms do not have large public company audit practices so the concept of public board members may be difficult).

¹⁵¹ See Mark Grothe and Blaine Post, Speak No Evil, Glass Lewis & Co Research 12 (May 21, 2007).

¹⁵² Form 8-K, available at <http://www.sec.gov/about/forms/form8-k.pdf>.

approximately 70% of the more than 1,300 auditor changes occurring in 2006.¹⁵³

The Committee considered testimony and commentary regarding the lack of clear disclosure surrounding auditor changes. Testimony and commentary viewed the lack of transparency surrounding auditor changes as detrimental to investor confidence in financial reporting.¹⁵⁴ Testimony and commentary suggested greater transparency regarding auditor changes would compel audit committees to more closely evaluate auditor selection decisions and lead to greater competition in the audit market.¹⁵⁵

The Committee believes that explicitly stating the reason for an auditor change will assist investors in determining the quality of financial reporting and subsequent investment decisions. The Committee recommends that the SEC amend its Form 8-K disclosure on auditor changes by providing for the following mechanism:¹⁵⁶ The public company

would file within four days of an auditor change a Form 8-K disclosing that an auditor had resigned, was terminated, or did not seek reappointment; the company would appropriately characterize and state in all cases in plain English the reason or reasons for the change. The company would also disclose whether its audit committee agreed with the disclosure it has provided. The company would also provide the auditor with a copy of the disclosure and request a response as to the accuracy of the disclosure. The company would include any response as an exhibit to the company's Form 8-K filing, or if received following the due date for the Form 8-K, in a subsequent Form 8-K. As discussed above under current SEC regulations, the public company can request that the auditor respond to the company's statements in the Form 8-K regarding disagreements over accounting and financial matters.

In addition, the Committee recommends that auditing firms notify the PCAOB of any engagement partner changes on public company audits if made before the normal rotation period and, other than for retirement, the reasons for those changes.¹⁵⁷

Letter Regarding Draft Report and Draft Report Addendum 27, (June 27, 2008), available at http://comments.treas.gov/_files/EYACAPCommentLetterFINAL.pdf (worrying that the results will be "boilerplate disclosure that is of little benefit to investors while an expansion of the list of objective criteria could be more useful"); Wayne Kolins, Director of Assurance, BDO Seidman LLP, Comment Letter Regarding Draft Report and Draft Report Addendum 4, (June 27, 2008) available at http://comments.treas.gov/_files/ResponsetoAdvisoryCommittee0627final.PDF (stating "a requirement for auditors to respond as to the accuracy of disclosures relating to subjective reasons is not feasible, since auditors have no basis for agreeing or disagreeing with management regarding why they dismissed the auditors").

¹⁵⁷ See, e.g., Record of Proceedings (Feb. 4, 2008) (Written Submission of Paul G. Haaga Jr., Vice Chairman, Capital Research and Management Company, 2), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Haaga020408.pdf> (calling for public disclosure on audit partner changes other than for rotation requirements); Record of Proceedings (Feb. 4, 2008) (Oral Remarks of D. Paul Regan, President and Chairman, Hemming Morse Inc., 194-195 (Feb. 4, 2008)), available at <http://www.treas.gov/offices/domestic-finance/acap/agendas/minutes-2-4-08.pdf> (commenting that "if an audit partner is * * * rotated [early] off of an issuer, there ought to be a disclosure, and there ought to be communication from the partner who was rotated off early as to [the reason for the early rotation] * * * because in many instances * * * there [i]s controversy * * *"). But, cf. Ernst & Young LLP Comment Letter Regarding Draft Report and Draft Report Addendum 27, (June 27, 2008), available at http://comments.treas.gov/_files/EYACAPCommentLetterFINAL.pdf ("Unscheduled changes in an engagement partner are often due to circumstances that have no impact on the relationship between the client and the Auditor"); Wayne Kolins, Director of Assurance, BDO Seidman LLP, Comment Letter Regarding Draft Report and Draft Report Addendum

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.

The auditor's report is the primary means by which the auditor communicates to the users of financial statements regarding its audit of financial statements. The standard auditor's report, not much altered since the 1930s,¹⁵⁸ identifies the financial statements audited, the scope and nature of the audit, the general responsibilities of the auditor and management, and the auditor's opinion.¹⁵⁹ In addition, for companies subject to Sarbanes-Oxley's internal control requirements, the auditor's report includes an attestation as to internal control over financial reporting.¹⁶⁰ The auditor's opinion on the financial statements states whether these statements present fairly, in all material respects, a company's financial position, results of operations, and cash flows in conformity with generally accepted accounting principles.¹⁶¹

Many consider the auditor's reporting model a pass/fail model because the auditor opines whether the statements are fairly presented (pass) or not (fail).¹⁶² Since the SEC does not accept filings with financial statements that

12, (June 27, 2008) available at http://comments.treas.gov/_files/ResponsetoAdvisoryCommittee0627final.PDF (stating that no benefit is gained in requiring notification to the PCAOB when there is premature changes in the engagement partner); PricewaterhouseCoopers, Comment Letter Regarding Draft Report and Draft Report Addendum 20, (June 30, 2008), available at http://comments.treas.gov/_files/PwCCommentLtrTreasCmtDraftandAddendum63008.pdf (noting that there are many reasons for the engagement partner to change including personal as well as professional and that the real issue is "whether the firm has the appropriate quality control processes in place").

¹⁵⁸ For a historical analysis of the evolution of the auditor's report, see George Cochrane, *The Auditor's Report: Its Evolution in the U.S.A.*, in *Perspectives in Auditing* 16 (D.R. Garmichael and John J. Willingham 2d. ed. 1975).

¹⁵⁹ Reports on Audited Financial Statements, Interim Auditing Standard AU Section 508.08 (Pub. Company Accounting Oversight Bd. 2002).

¹⁶⁰ An Audit of Internal Control Over Financial Reporting That Is Integrated With An Audit of Financial Statements, Auditing Standard No. 5, para. 85 (Pub. Company Accounting Oversight Bd. 2007).

¹⁶¹ Reports on Audited Financial Statements, Interim Auditing Standard AU Section 508.07-.08 (Pub. Company Accounting Oversight Bd. 2002).

¹⁶² Public Company Accounting Oversight Board, Standing Advisory Group Meeting Briefing Paper: Auditor's Reporting Model 3 (Feb. 16, 2005).

¹⁵³ See Mark Grothe and Blaine Post, *Speak No Evil*, Glass Lewis & Co Research 12 (May 21, 2007).

¹⁵⁴ See, e.g., Andrew D. Bailey, Jr., Professor of Accountancy-Emeritus, University of Illinois, and Senior Policy Advisor, Grant Thornton LLP, Comment Letter Regarding Discussion Outline 4 (Jan. 30, 2008), available at http://comments.treas.gov/_files/Baileycommentsontreasurysurveysadvisorycommitteoutlinefinalsubmission13008.doc (recommending SEC and PCAOB disclosures of auditor changes to enhance the growth of smaller auditing firms); Record of Proceedings (Feb. 4, 2008) (Oral Remarks of Edward E. Nusbaum, Chief Executive Officer, Grant Thornton LLP, and Chairman, Grant Thornton International Board of Governors, 193-94), available at <http://www.treas.gov/offices/domestic-finance/acap/agendas/minutes-2-4-08.pdf> (calling for expanded Form 8-K disclosure requirements as "in the best interest of investors").

¹⁵⁵ See, e.g., Record of Proceedings (Feb. 4, 2008) (Written Submission of Edward E. Nusbaum, Chief Executive Officer, Grant Thornton LLP, and Chairman, Grant Thornton International Board of Governors, 3), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Nusbaum020408.pdf> (noting that the Committee should examine "[c]omprehensive disclosures about reasons for auditor switches").

¹⁵⁶ See Record of Proceedings (June 3, 2008) (Written Submission of Kenneth Nielsen Goldmann, Capital Markets and SEC Practice Director, J.H. Cohn LLP, 4), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Goldmann060308.pdf> (recommending additional disclosure regarding the relationship between the successor auditor and the company); Dennis Johnson, CFA, Senior Portfolio Manager, CalPERS, Comment Letter Regarding Draft Report and Draft Report Addendum 3, (June 13, 2008), available at http://comments.treas.gov/_files/200806_13ACAP_addendum_commentltr.pdf (supporting the Recommendation); Record of Proceedings (June 3, 2008) (Written Submission of Nell Minow, Editor and Co-Founder, The Corporate Library, 2), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Minow060308.pdf> (stating that the Recommendation seems consistent with Sarbanes-Oxley Act). But, cf. Ernst & Young LLP Comment

“fail,”¹⁶³ the vast number of audit reports issued rarely departs from the exact standardized wording. Some believe this pass/fail model with its standardized wording does not adequately reflect the amount of auditor work and judgment.

Over thirty years ago, the audit “expectations gap” was coined¹⁶⁴ and has been a topic of controversy ever since. The expectations gap has been defined as “the difference between what the public and users of financial statements perceive the role of an audit to be and what the audit profession claim is expected of them during the conduct of an audit.”¹⁶⁵ The Committee considered testimony and commentary regarding this “expectations gap” between the public’s expectations regarding auditor responsibility for fraud detection and the auditor’s required and capable performance of fraud detection.¹⁶⁶

¹⁶³ SEC Staff Accounting Bulletin, Topic 1E—Requirements for Audited or Certified Financial Statements [Interpretive response to question 2], (stating, in part, “[a]ccordingly, auditor reports filed with the SEC must include unqualified opinions”).

¹⁶⁴ C.D. Liggio, *The Expectation Gap: The Accountant’s Waterloo* Vol. 3 No. 3 *Journal of Contemporary Business* 27 (1974).

¹⁶⁵ Marianne Ojo, *Eliminating the Audit Expectations Gap: Myth or Reality?*, (Feb. 2006), available at http://mpr.ub.uni-muenchen.de/232/1/Mpra_paper_232.pdf.

¹⁶⁶ See, e.g., Andrew D. Bailey, Jr., Professor of Accountancy—Emeritus, University of Illinois, and Senior Policy Advisor, Grant Thornton LLP, *Comment Letter Regarding Discussion Outline 4* (Jan. 30, 2008), available at http://comments.treas.gov/_files/BAILEYCOMMENTSONTREASURYADVISORYCOMMITTEEOUTLINEFINALSUBMISSION13008.doc (stating that “[i]f the discovery of material errors and fraud is not a major part of what the audit is about, it is not clear what value-added service the auditor offers the investor and capital markets”); *Record of Proceedings* (Feb. 4, 2008) (Questions for the Record of Cynthia M. Fornelli, Executive Director, Center for Audit Quality, 5 (Mar. 31, 2008), available at <http://www.treas.gov/offices/domestic-finance/acap/agendas/QFRs-2-4-08.pdf> (“While auditors provide reasonable assurance that fraud material to the financial statements will be detected, they cannot be expected to provide absolute assurance that all material fraud will be found. Cost-benefit constraints and the lack of governmental subpoena and investigative powers, among other factors, make absolute assurance impossible.”); *Record of Proceedings* (Feb. 4, 2008) (Written Submission of Dennis Johnson, California Public Employees’ Retirement System, 5), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Johnson020408.pdf> (stating that “[o]f critical importance to investors is the responsibility of auditors to detect fraud and improve the timely communication of these frauds to investors and shareowners.”); *Serving Global Capital Markets and the Global Economy: A View From the CEOs of the International Audit Networks* 12 (Nov. 2006) (“Nonetheless, there is a significant ‘expectations gap’ between what various stakeholders believe auditors should do in detecting fraud, and what audit networks are actually capable of doing, at the prices that companies or investors are willing to pay for audits.”).

Public investors have appropriately raised questions when large frauds have gone undetected. Among the attributes that the public expects of auditors is a clear acknowledgment of their responsibility for the reliability of financial statements, particularly with respect to the detection of fraud, notwithstanding the recognition that a company’s management and board have the primary role in preventing fraud.¹⁶⁷ Some say the public may believe that auditors will detect more fraud than those in the profession believe can be reasonably expected. Both beliefs may be unreasonable in some circumstances. And, there are difficulties of detecting fraud, especially before it has resulted in a material misstatement. However, even those involved directly in the audit process on a daily basis from time to time have differing views as to what the auditor should and should not have been expected to discover.

According to existing auditing standards and SEC rules, management prepares and has the primary responsibility for the accuracy of financial statements and for prevention and identification of fraud and the auditor’s role is to provide reasonable assurance that the financial statements are free of material misstatement.¹⁶⁸ These concepts are embedded in the current auditing and audit reporting standards that require that the auditor “plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement whether caused by error or fraud.”¹⁶⁹ It is noteworthy that the current standard auditor’s report does not actually mention “fraud” and is silent about the auditor’s responsibility to find fraud.

Clarification of the expectations gap and confusion about auditor

¹⁶⁷ See, e.g., Sir David Tweedie, *Challenges Facing the Auditor: Professional Fouls and the Expectation Gap*, Deloitte, Haskins and Sells Lecture, University College, Cardiff 20 (“The public appears to require (1) a burglar alarm system (protection against fraud) * * * (2) a radar station (early warning of future insolvency) * * * (3) a safety net (general re-assurance of financial well-being) * * * (4) an independent auditor (safeguards for auditor independence) * * * and (5) coherent communications (understanding of audit reports)”).

¹⁶⁸ See, e.g., *Commission on Auditors’ Responsibilities, Report, Conclusions, and Recommendations* xii (1978) (concluding that, after having been established to investigate the existence of such a gap, “[a]fter considerable study of available evidence and its own research.....such a gap does exist”). For a more recent article, see Dan L. Goldwasser, *The Past and Future of Reasonable Assurance*, *The CPA Journal* (Nov. 2005), available at http://www.nysscpa.org/cpajournal/2005/1105/special_issue/essentials/p28.htm.

¹⁶⁹ *Consideration of Fraud in a Financial Statement, Interim Auditing Standard AU 316* (Pub. Company Accounting Oversight Bd. 2002).

responsibility to detect fraud are not the only criticisms of the standard auditor’s report. Over the years there have been numerous recommendations that the standard report be improved. In 1978, the Commission on Auditors’ Responsibilities (Cohen Commission) made a simple observation: “For the largest corporations in the country, an audit may involve scores of auditors and tens of thousands of hours of work for which the client may pay millions of dollars. Nevertheless, the auditor’s standard report compresses that considerable expenditure of skilled effort into a relatively few words and paragraphs.”¹⁷⁰ The Cohen Commission then called for an expansion of the auditor’s report to include a report not merely on the financial statements, but covering the entire audit function.¹⁷¹ The Cohen Commission reasoned that this new more comprehensive information would benefit users, but also clarify the role and, consequently, the legal standing of the auditor in relation to the audit.¹⁷²

In 1987, the National Commission on Fraudulent Financial Reporting (Treadway Commission) recommended that the standard auditor’s report more clearly identify the auditor’s responsibilities, the degree to which users can rely on the audit, and the limitations on the audit process.¹⁷³ The Treadway Commission aimed to reaffirm that management has “primary responsibility for financial statements” and to caution users of financial statements from placing more than “reasonable” assurance on the audit process.

More recently, the American Assembly called for differing attestation standards for different parts of the financial statements, depending on the amount of uncertainty and judgment required in making certain determinations.¹⁷⁴ In addition, a February 2008 CFA Institute survey indicated that 80% of its member respondents believe that the auditor’s report should provide specific information about how the auditor

¹⁷⁰ *Commission on Auditors’ Responsibilities, Report, Conclusions, and Recommendations* 71 (1978).

¹⁷¹ *Commission on Auditors’ Responsibilities, Report, Conclusions, and Recommendations* 75 (1978).

¹⁷² *Commission on Auditors’ Responsibilities, Report, Conclusions, and Recommendations* 75–76 (1978).

¹⁷³ *National Commission on Fraudulent Financial Reporting, Report of the National Commission on Fraudulent Financial Reporting* (Oct. 1987).

¹⁷⁴ *American Assembly, The Future of the Accounting Profession* 12–13 (Nov. 13–15, 2003); *American Assembly, The Future of the Accounting Profession: Auditor Concentration* 21 (May 23, 2005).

reached its opinion.¹⁷⁵ A majority of survey respondents thought it was very important to have the auditors identify key risk areas, significant changes in risk exposures, and amounts either involving a high degree of uncertainty in measurement and significant assumptions or requiring a higher level of professional judgment.¹⁷⁶

In 2005, the PCAOB's Standing Advisory Group (SAG), which advises the PCAOB on the establishment of auditing and related professional practice standards, considered whether the auditor's report should include more information relating to the auditor's judgments regarding financial reporting quality.¹⁷⁷ The SAG also considered whether required auditor communications to audit committees, such as the auditor's judgments about accounting principles¹⁷⁸ and critical accounting policies and practices,¹⁷⁹ should be incorporated into the auditor's report.¹⁸⁰ The PCAOB has not yet taken up a standard-setting initiative regarding the auditor's report.

Foreign jurisdictions are also currently considering changes to their auditor's reports. For instance, the European Commission under the Eighth Directive is authorized to develop its own "European Audit Report" or adopt the International Federation of Accountants' International Auditing and Assurance Standards Board's recently revised auditor's report standard.¹⁸¹ In December 2007, the Audit Practices Board, a part of the United Kingdom's Financial Reporting Council, issued a Discussion Paper seeking comment on potentially altering the auditor's report.¹⁸² Currently in Germany, public companies are generally required to

issue a long-form auditor's report, discussing matters such as the company's economic position and trend of business operations and the nature and scope of the auditor's procedures. The Committee is cognizant that this debate over such disclosures is unfolding in a litigation environment different from that in the United States.

This Committee has also heard testimony regarding expanding the auditor's report.¹⁸³ One witness noted that some institutional investors believe an expanded auditor's report would enhance investor confidence in financial reporting and recommended exploring a more "narrative" report in areas, such as "estimates, judgments, sufficiency of evidence and uncertainties."¹⁸⁴

The Committee notes that the increasing complexity of global business operations are compelling a growing use of judgments and estimates, including those related to fair value measurements, and also contributing to greater complexity in financial reporting. The Committee believes this complexity supports improving the content of the auditor's report beyond the current pass/fail model to include a more relevant discussion about the audit of the financial statements. While there is not yet agreement as to precisely what additional information is sought by and would be useful to investors and other users of financial statements, the Committee concludes that an improved auditor's report would likely lead to more relevant information for users of financial statements and would clarify the role of the auditor in the financial statement audit.

The Committee therefore recommends that the PCAOB address these issues, both long-debated and increasingly important given the use of judgments

and estimates, by undertaking a standard-setting initiative to consider improvements to the auditor's reporting model.¹⁸⁵ With regards to this initiative, the PCAOB should consult with investors, other financial statement users, auditing firms, public companies, academics, other market participants, and other state, federal, and foreign regulators. In view of the desirability of improving the quality of financial reporting and auditing on a global basis, the PCAOB should also consider the developments in foreign jurisdictions that improve the quality and content of the auditor's report and should consult with international regulatory bodies as appropriate. The PCAOB should also take cognizance of the proposal's potential legal ramifications, if any, to auditors.¹⁸⁶

¹⁸⁵ See, e.g., Deloitte LLP, Comment Letter Regarding Draft Report and Draft Report Addendum 20 (June 27, 2008), available at http://comments.treas.gov/_files/DeloitteLLPCommentLetter.pdf (recommending that the Committee suggest to the PCAOB to include the International Auditing and Assurance Standards Board (IAASB) and the Auditing Standards Board (ASB), who are evaluating the auditor's report, in undertaking this initiative); Roderick Hills, Chairman, Center for Strategic and International Studies, Hills Program on Governance, Comment Letter Regarding Discussion Outline 3 (June 5, 2008), available at http://comments.treas.gov/_files/commentsregardingdraftreportofadvisorycomm.pdf (agreeing that a new auditor's report standard is needed to allow auditors to offer a range of attestations to reflect the range of values possible); Dennis Johnson, CFA, Senior Portfolio Manager, CalPERS, Comment Letter Regarding Draft Report and Draft Report Addendum 1-2. (June 13, 2008), available at http://comments.treas.gov/_files/200806_13ACAP_addendum_commentltr.pdf (supporting the Recommendation). But, cf., Arnold Hanish, Financial Executives International, Chair, Committee on Corporate Reporting, Comment Letter Regarding Draft Report and Draft Report Addendum 4-5 (July 3, 2008), available at http://comments.treas.gov/_files/FEICCRTreasuryACAPCommentLetterFiled73080.pdf (suggesting that the Recommendation "can add even more stress to an already stressed system" and that changes can cause confusion); Lee Seidler, CPA, Comment Letter Regarding Draft Report and Draft Report Addendum (June 27, 2008), available at http://comments.treas.gov/index.cfm?FuseAction=Home.View&Topic_id=9&FellowType_id=1&CurrentPage=1 (stating that expansion always includes exculpatory language that is not useful).

¹⁸⁶ See, e.g., Deloitte LLP, Comment Letter Regarding Draft Report and Draft Report Addendum 20 (June 27, 2008), available at http://comments.treas.gov/_files/DeloitteLLPCommentLetter.pdf ("[T]he different liability systems where these reports exist must be taken into account when assessing the standard language included in the auditor's report in the U.S. and the U.S. litigation system"); Cynthia Fornelli, Executive Director, Center for Audit Quality, Comment Letter Regarding Draft Report and Draft Report Addendum 22, (June 27, 2008), available at http://comments.treas.gov/_files/CAQCommentLetter62708FINAL.pdf (suggesting the Committee "acknowledge that the risk of catastrophic liability must inform any potential changes to the auditor's report"); PricewaterhouseCoopers, Comment Letter

¹⁷⁵ CFA Institute, February 2008 Monthly Question Results (Feb. 2008), available at <http://www.cfainstitute.org/memresources/monthlyquestion/2008/february.html>.

¹⁷⁶ CFA Institute, February 2008 Monthly Question Results (Feb. 2008), available at <http://www.cfainstitute.org/memresources/monthlyquestion/2008/february.html>.

¹⁷⁷ Public Company Accounting Oversight Board, Standing Advisory Group Meeting: Auditor's Reporting Model (Feb. 16, 2005).

¹⁷⁸ For this requirement, see Communications With Audit Committees, Interim Auditing Standard AU Section 380.11 (Public Company Accounting Oversight Bd. 2002).

¹⁷⁹ For this requirement, see Sarbanes-Oxley Act, 15 U.S.C. § 78j-1 (2002).

¹⁸⁰ Public Company Accounting Oversight Board, Standing Advisory Group Meeting: Auditor's Reporting Model 4-5 (Feb. 16, 2005).

¹⁸¹ Directive 2006/43/EC of the European Parliament and of the Council Art. 28 (May 17, 2006); Auditing Practices Board, Discussion Paper—The Auditor's Report: A Time For Change? 6 (Dec. 2007).

¹⁸² Auditing Practices Board, Discussion Paper—The Auditor's Report: A Time For Change? (Dec. 2007).

¹⁸³ See, e.g., Record of Proceedings (Dec. 3, 2007) (Written Submission of Dennis M. Nally, Chairman and Senior Partner, PricewaterhouseCoopers LLP, 7), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Nally120307.pdf> (supporting the Committee's considering whether to change the auditor's report's content given single financial reporting standards, more cohesive global auditing standards, and trends, like fair value measurement); Record of Proceedings (Dec. 3, 2007) (Oral Remarks of Ashwinpaul C. Sondhi, President, A. C. Sondhi & Associates, LLC, 255-57), available at <http://www.treas.gov/offices/domestic-finance/acap/agendas/minutes-12-3-07.pdf>; Record of Proceedings (Dec. 3, 2007) (Oral Remarks of James S. Turley, Chairman and Chief Executive Officer, Ernst & Young LLP, 253-54), available at <http://www.treas.gov/offices/domestic-finance/acap/agendas/minutes-12-3-07.pdf>.

¹⁸⁴ Record of Proceedings (Feb. 4, 2008) (Written Submission of Richard Fleck, Global Relationship Partner, Herbert Smith LLP, 17, 21), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Fleck02042008.pdf>.

Commentary has also suggested that auditors must more effectively communicate their responsibility regarding fraud detection with investors and the capital markets. The Committee agrees with this suggestion. Accordingly, the Committee believes that the auditor's report should articulate clearly to investors the auditor's role and limitations in detecting fraud.¹⁸⁷ The Committee believes that expressly communicating to investors, other financial statement users, and the public the role of auditors in finding and reporting fraud would help narrow the "expectations gap."

In addition, the Committee recommends that the PCAOB and the SEC clarify in the auditor's report the auditor's role and limitations in detecting fraud under current auditing standards. In addition, the Committee recommends, in light of this continuing "expectations gap," that the PCAOB review the auditing standards governing fraud detection and fraud reporting. Specifically, the Committee recommends that the PCAOB periodically review and update these standards.¹⁸⁸

Recommendation 6: Urge the PCAOB to undertake a standard-setting initiative to consider mandating the engagement

Regarding Draft Report and Draft Report Addendum 11, (June 30, 2008), available at http://comments.treas.gov/_files/PwCCommentLtrTreasCmtDraftandAddendum63008.pdf (acknowledging that litigation issues must be taken into account).

¹⁸⁷ See, e.g., Joseph Carcello, Chair, AAA Task Force to Monitor the Activities of the Treasury ACAP Ernst & Young Professor and Director of Research—Corporate Governance Center University of Tennessee, Jean C. Bedard Timothy B. Harbert Professor of Accountancy Bentley College, Dana R. Hermanson Dinos Eminent Scholar Chair of Private Enterprise and Professor of Accounting Kennesaw State University, Comment Letter Regarding Draft Report and Draft Report Addendum 6, (May 15, 2008), available at http://comments.treas.gov/_files/ACAPCommentLetterMay152008.pdf (urging the PCAOB to evaluate the efficacy of SAS No. 99); Cynthia Fornelli, Executive Director, Center for Audit Quality, Comment Letter Regarding Draft Report and Draft Report Addendum 26, (June 27, 2008), available at http://comments.treas.gov/_files/CAQCommentLetter62708FINAL.pdf (supporting the Recommendation); Frank Frankowski, CFO, Airborne Systems, Comment Letter Regarding Draft Report and Draft Report Addendum 2, (June 2, 2008), available at http://comments.treas.gov/_files/FrankowskiLetter.pdf; Record of Proceedings (June 3, 2008) (Written Submission of Dan Guy, Former Vice President, Professional Standards and Services, American Institute of Certified Public Accountants, 2), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Guy060308.pdf> (recommending the addition of illegal acts to the Recommendation).

¹⁸⁸ Donald Chapin, Comment Letter Regarding Draft Report and Draft Report Addendum 1, (June 9, 2008), available at http://comments.treas.gov/_files/TreasuryAdvisoryCommittee.doc (supporting the Recommendation).

partner's signature on the auditor's report.

SEC regulations require that the auditor's report be signed.¹⁸⁹ Under current requirements, the auditor's report signature block shows the auditing firm's name, not the engagement partner's. In 2005, the PCAOB's SAG considered whether the audit partner and a concurring partner should sign the auditor's report in their own names.¹⁹⁰ The Committee has received testimony and commentary regarding the benefits and complexities of engagement partner signatures.¹⁹¹ The Committee has also discussed and debated the merits of the senior engagement partner signing the auditor's report.¹⁹² Advocates believe that such signatures will foster greater accountability of the individuals signing the auditor's report, will enhance transparency, and may improve audit quality, and they also note the signature will create no additional liability concerns for the engagement partner.¹⁹³ These supporters analogize the signatures to the chief executive officer and chief financial officer certifications under Section 302 of Sarbanes-Oxley and directors' signatures on public company annual reports. The signature will also enhance the status of the engagement partner, putting the partner

¹⁸⁹ SEC Regulation S-X, Rule 2-02a.

¹⁹⁰ Public Company Accounting Oversight Board, Standing Advisory Group Meeting: Auditor's Reporting Model 7-8 (Feb. 16, 2005).

¹⁹¹ See, e.g., Record of Proceedings (Feb. 4, 2008) (Written Submission of Paul G. Haaga, Jr., Vice Chairman, Capital Research and Management Company, 2), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Haaga020408.pdf> (stating that signatures could improve audit quality and enhance accountability).

¹⁹² See, e.g., Record of Proceedings (Mar. 13, 2008) (Oral Remarks of Donald T. Nicolaisen, Board Member, Morgan Stanley, 228-230) (stating his belief that engagement partner should sign the auditor's report); Record of Proceedings (Mar. 13, 2008) (Oral Remarks of Mary Bush, Board Member, Discover Financial Services, 231) (endorsing the engagement partner signature on the auditor's report).

¹⁹³ See, e.g., Donald Chapin, Comment Letter Regarding Draft Report and Draft Report Addendum 2, (June 9, 2008), available at http://comments.treas.gov/_files/TreasuryAdvisoryCommittee.doc (suggesting that if the engagement partner and concurring partner sign the auditor's report separately, some type of liability limitations should be received if the firm is not complicit in the audit failure); Dennis Johnson, CFA, Senior Portfolio Manager, CalPERS, Comment Letter Regarding Draft Report and Draft Report Addendum 2, (June 13, 2008), available at http://comments.treas.gov/_files/200806_13ACAP_addendum_commentltr.pdf (supporting the Recommendation); Paul Lee, Director, Hermes Equity Ownership Services Limited, Comment Letter Regarding Draft Report and Draft Report Addendum 4, (June 13, 2008), available at http://comments.treas.gov/_files/ACAPresponse13Jun08.pdf (noting that the signatures would increase accountability and professionalism).

on the same level as the chief executive officer and chief financial officer.

Opponents of such signatures argue that the auditing firm operates as a team and takes responsibility for the audit, but not individual partners. They also argue that no improvement in audit quality will result from such a signature.¹⁹⁴

The Committee notes that engagement partner signatures are required in other jurisdictions. The European Union's (EU) Eighth Directive requires that the engagement partner sign the auditor's report.¹⁹⁵ Even prior to the Eighth Directive, several European countries, including France, Germany, and Luxembourg, required engagement partner signatures for a number of years.¹⁹⁶

The Committee notes that in Chapter VII of this Report, the Committee is recommending disclosure of the name(s) of the senior audit partner(s) staffed on the engagement in the proxy statement to increase transparency and affirm the accountability of the auditor.

The Committee believes that the engagement partner's signature on the

¹⁹⁴ See, e.g., Deloitte LLP, Comment Letter Regarding Draft Report and Draft Report Addendum 21 (June 27, 2008), available at http://comments.treas.gov/_files/DeloitteLLPCommentLetter.pdf (arguing that regulators and others can already identify those involved in audits); Arnold Hanish, Financial Executives International, Chair, Committee on Corporate Reporting, Comment Letter Regarding Draft Report and Draft Report Addendum 5 (July 3, 2008), available at http://comments.treas.gov/_files/FEICCRTreasuryACAPCommentLetterFiled73080.pdf (stating that partners could become excessively conservative and seek multiple opinions from the national office before signing their name); Wayne Kolins, Director of Assurance, BDO Seidman LLP, Comment Letter Regarding Draft Report and Draft Report Addendum 14-15, (June 27, 2008) available at http://comments.treas.gov/_files/ResponseToAdvisoryCommittee0627final.PDF (noting that an audit is a team effort and focusing on one partner may reduce other engagement staff's sense of responsibility); Mayer Hoffman McCann P.C., Comment Letter Regarding Draft Report and Draft Report Addendum 3, (June 17, 2008), available at http://comments.treas.gov/_files/MayerHoffmanMcCannCommentLetter.pdf (stating that the Recommendation "may be counterproductive since large audits require many partners in various parts of the country or world"); PricewaterhouseCoopers, Comment Letter Regarding Draft Report and Draft Report Addendum 11-12, (June 30, 2008), available at http://comments.treas.gov/_files/PwCCommentLtrTreasCmtDraftandAddendum63008.pdf (discerning no clear benefit from the Recommendation).

¹⁹⁵ Directive 2006/43/EC of the European Parliament and of the Council Art. 28 (May 17, 2006).

¹⁹⁶ The Institute of Chartered Accountants in England and Wales, Shareholder Involvement—Identifying the Audit Partner (2005) (noting that Germany, France, and Luxembourg currently require audit partner signatures and European Member states must adopt such a requirement under Article 28 of the Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts).

auditor's report would increase transparency and accountability. Therefore, the Committee recommends that the PCAOB undertake a standard-setting initiative to consider mandating the engagement partner's signature on the auditor's report. The Committee notes the signature requirement should not impose on any signing partner any duties, obligations or liability that are greater than the duties, obligations and liability imposed on such person as a member of an auditing firm.¹⁹⁷

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.

The Committee considered testimony and commentary regarding the transparency of auditing firms.¹⁹⁸ The Committee has reviewed and considered a range of transparency reporting options, including the PCAOB's May 2006 proposal, now finalized, requiring annual and periodic reporting pursuant to the mandate under Sarbanes-Oxley's Section 102(d).¹⁹⁹ This rule requires annual reporting by auditing firms on such items as a public company audit client list and the percentage of the firm's total fees attributable to public company audit clients for each of the following categories of services: audit services, other accounting services, tax services, and non-audit services. The PCAOB rule also requires firms to file a "special" report, triggered by such

events as the initiation of certain criminal or civil governmental proceedings against the firm or its personnel; a new relationship with a previously disciplined person or entity; or the firm becoming subject to bankruptcy or similar proceedings.

The Committee has also considered the EU's Eighth Directive, Article 40 Transparency Report,²⁰⁰ which requires that public company auditors post on their websites annual reports including the following information: legal and network structure and ownership description; governance description; most recent quality assurance review; public company audit client list; independence practices and confirmation of independence compliance review; continuing education policy; financial information, including audit fees, tax advisory fees, consulting fees; and partner remuneration policies. The Article 40 Transparency Report also requires a description of the auditing firm's quality control system and a statement by firm management on its effectiveness. Auditing firms and investors have expressed support for requiring U.S. auditing firms to publish reports similar to the Article 40 Transparency Report.²⁰¹

The Committee notes that Recommendation 3 in Chapter VI of this Report recommends that, if feasible, the PCAOB develop audit quality indicators and auditing firms publish these indicators. The Committee believes this information could improve audit quality by enhancing the transparency of auditing firms and notes that some foreign affiliates of U.S. auditing firms

provide such indicators in public reports issued in other jurisdictions.²⁰²

Furthermore, for several years auditing firms in the United Kingdom have published annual reports containing audited financial statements pursuant to limited liability partnership disclosure requirements as well as a discussion of those statements, a statement on corporate governance, performance metrics, and other useful information. In the United States, auditing firms typically do not prepare audited financial statements. Some witnesses have called for the public disclosure of audited financial statements,²⁰³ whereas one auditing firm representative questioned the usefulness of disclosing financial statements of the smaller auditing firms.²⁰⁴ The Committee received

²⁰² See, e.g., Record of Proceedings (Feb. 4, 2008) (Written Submission of Dennis Johnson, Senior Portfolio Manager, Corporate Governance, California Public Employees' Retirement System, 5), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Johnson020408.pdf> (recommending auditing firm disclosure of key performance indicators, such as "percent of training dollars spent on staff compared to the fees received for the audit, average experience of staff, partner time allocated to each audit").

²⁰³ See, e.g., Record of Proceedings (June 3, 2008) (Written Submission of John Biggs, Audit Committee Chair, Boeing, Inc., former Chief Executive Officer and Chairman, TIAA-CREF), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Biggs060308.pdf> (stating that audited financial statements would be useful for audit committees); James D. Cox, Duke University, and Lawrence A. Cunningham, George Washington University, Comment Letter Regarding Draft Report and Draft Report Addendum 1-2, (July 4, 2008), available at http://comments.treas.gov/_files/JointCommentLetteronFACAPJuly2008.doc (supporting financial statement disclosure for assessing audit quality and independence); Record of Proceedings (Feb. 4, 2008) (Written Submission of Paul G. Haaga, Jr., Vice Chairman, Capital Research and Management Company, 2), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Haaga020408.pdf> (calling for auditing firm disclosure of audited financial statements); Dennis Johnson, CFA, Senior Portfolio Manager, CalPERS, Comment Letter Regarding Draft Report and Draft Report Addendum 3, (June 13, 2008), available at http://comments.treas.gov/_files/200806_13ACAP_addendum_commentltr.pdf (recommending that all audited financial statements be publicly available on the PCAOB's website).

²⁰⁴ Record of Proceedings (Feb. 4, 2008) (Questions for the Record of Neal Spencer, Managing Partner, BKD LLP, 38-39), available at <http://www.treas.gov/offices/domestic-finance/acap/agendas/QFRs-2-4-08.pdf> (analagizing the auditing firm to a vendor and noting that the profitability or financial strength of vendors "has little, if any, relevance other than perhaps related to concerns about their ability to financially support their continued existence" and noting that the profitability or financial condition of an auditing firm is not directly related to audit quality; and noting that the "most relevant financial information for users" of smaller auditing firms is insurance-related information and noting that larger auditing firms with limited commercial insurance coverage may need to disclose different financial information).

²⁰⁰ Directive 2006/43/EC of the European Parliament and of the Council Art. 40 (May 17, 2006), available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:157:0087:0107:EN:PDF>.

²⁰¹ See, e.g., Record of Proceedings (Feb. 4, 2008) (Written Submission of Paul G. Haaga, Jr., Vice Chairman, Capital Research and Management Company, 2), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Haaga020408.pdf> (recommending auditing firm disclosure of quality control policies and procedures); Record of Proceedings (Feb. 4, 2008) (Written Submission of Edward E. Nusbaum, Chief Executive Officer, Grant Thornton LLP, 6), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Nusbaum020408.pdf> (supporting an annual transparency report for U.S. auditing firms); Record of Proceedings (Written Submission of James S. Turley, Chairman and Chief Executive Officer, Ernst & Young LLP, 10), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Turley120307.pdf> (suggesting the PCAOB require auditing firms to publish transparency reports like the European Union's Article 40 Transparency Report).

¹⁹⁷ This language is similar to safe harbor language the SEC promulgated in its rulemaking pursuant to Sarbanes-Oxley's Section 407 for audit committee financial experts. See, SEC, Final Rule: Disclosure Required by Sections 406 and 407 of the Sarbanes-Oxley Act of 2002, Release No. 33-8177 (Jan. 23, 2003).

¹⁹⁸ See, e.g., Record of Proceedings (Dec. 3, 2007) (Written Submission of James S. Turley, Chairman and Chief Executive Officer, Ernst & Young LLP, 10), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Turley120307.pdf>; Record of Proceedings (Feb. 4, 2008) (Written Submission of Dennis Johnson, Senior Portfolio Manager, Corporate Governance, California Public Employees' Retirement System, 5), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Johnson020408.pdf>.

¹⁹⁹ See PCAOB, Proposed Rules on Periodic Reporting by Registered Public Accounting Firms, available at http://www.pcaobus.org/rules/docket_019/2006-05-23_release_no._2006-004.pdf.

testimony and commentary opposed to the public release of financial statements.²⁰⁵

The Committee recommends that the PCAOB require that, beginning in 2010, larger auditing firms (those with 100 or more public company audit clients that the PCAOB inspects annually) produce a public annual report incorporating (a) information required by the Article 40 Transparency Report deemed appropriate by the PCAOB in consultation with investors, other financial statement users, auditing firms, public companies, academics, and other market participants, and (b) such key indicators of audit quality and effectiveness as determined by the PCAOB in accordance with Recommendation 3 in Chapter VII of this Report. These disclosure requirements should supplement any rules approved by the SEC as a result of the PCAOB's May 2006 reporting proposal.

Further, the Committee also recommends that the PCAOB require that, beginning in 2011, the larger auditing firms file with the PCAOB on a confidential basis audited financial statements prepared in accordance with generally accepted accounting

principles or international financial reporting standards.

The Committee also recommends that the PCAOB determine which of the requirements included above should be imposed on smaller auditing firms (those with fewer than 100 public company audit clients), taking into account these firms' size and resources.

VI. Concentration and Competition

The Committee analyzed public company audit market concentration and competition. In its work the Committee focused on concentration and competition in the context of their impact on audit quality and effectiveness. In turn, consideration of the sustainability of the auditing profession was also subject to examination in the context of audit quality and effectiveness. The recommendations set out below reflect this focus.

During the course of its deliberations, the Committee received testimony and commentary from the Government Accountability Office (GAO), the Public Company Accounting Oversight Board (PCAOB), academics, auditing firms, investors, and others regarding audit market concentration and competition.

In January 2008, the GAO issued *Audits of Public Companies: Continued Concentration in Audit Market for Large Public Companies Does Not Call for Immediate Action*,²⁰⁶ updating its 2003 report on audit market concentration.²⁰⁷

²⁰³ See, e.g., Record of Proceedings (June 3, 2008) (Written Submission of John Biggs, Audit Committee Chair, Boeing, Inc., former Chief Executive Officer and Chairman, TIAA-CREF), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Biggs060308.pdf> (stating that audited financial statements would be useful for audit committees); James D. Cox, Duke University, and Lawrence A. Cunningham, George Washington University, Comment Letter Regarding Draft Report and Draft Report Addendum 1-2, (July 4, 2008), available at http://comments.treas.gov/_files/JointCommentLetteronFACAPJuly2008.doc (supporting financial statement disclosure for assessing audit quality and independence); Record of Proceedings (Feb. 4, 2008) (Written Submission of Paul G. Haaga, Jr., Vice Chairman, Capital Research and Management Company, 2), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Haaga020408.pdf> (calling for auditing firm disclosure of audited financial statements); Dennis Johnson, CFA, Senior Portfolio Manager, CalPERS, Comment Letter Regarding Draft Report and Draft Report Addendum 3, (June 13, 2008), available at http://comments.treas.gov/_files/200806_13ACAP_addendum_commentltr.pdf (recommending that all audited financial statements be publicly available on the PCAOB's website).

²⁰⁴ Record of Proceedings (Feb. 4, 2008) (Questions for the Record of Neal Spencer, Managing Partner, BKD LLP, 38-39), available at <http://www.treas.gov/offices/domestic-finance/acap/agendas/QFRs-2-4-08.pdf> (analogizing the auditing firm to a vendor and noting that the profitability or financial strength of vendors "has little, if any, relevance other than perhaps related to concerns about their ability to financially support their continued existence" and noting that the profitability or financial condition of an auditing firm is not directly related to audit quality; and noting that the "most relevant financial information for users" of smaller auditing firms is insurance-related information and noting that larger auditing firms with limited commercial insurance coverage may need to disclose different financial information).

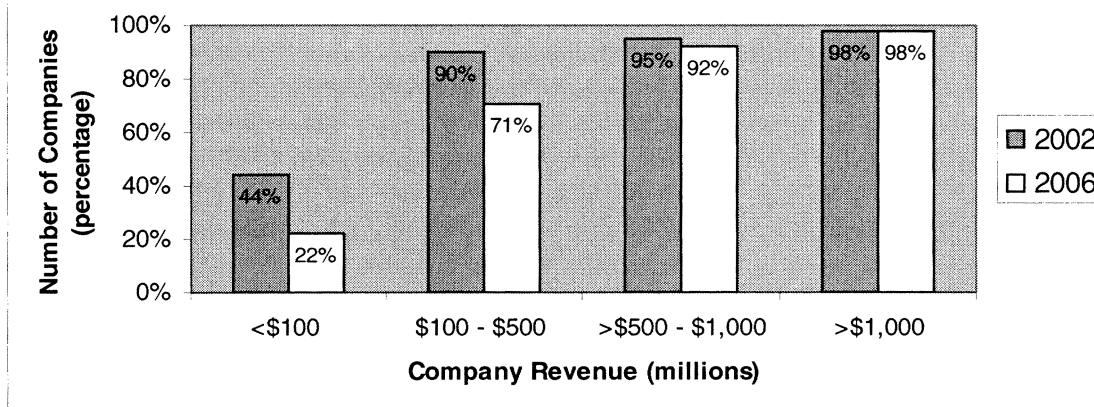
²⁰⁵ Deloitte LLP, Comment Letter Regarding Draft Report and Draft Report Addendum 20 (June 27, 2008), available at http://comments.treas.gov/_files/DeloitteLLPCommentLetter.pdf (opposing disclosure of financial statements due to increased

The GAO concluded that the four largest auditing firms continue to dominate the large public company audit market. In 2006, the four largest auditing firms audited 98% of the 1500 largest public companies with annual revenues over \$1 billion and 92% of public companies with annual revenues between \$500 million and \$1 billion. However, concentration in the small and mid-size public company audit market has eased during the past five years. The largest firms' share in auditing small public companies with annual revenues under \$100 million has declined from 44% in 2002 to 22% in 2006 and in auditing mid-size public companies with annual revenue between \$100 million and \$500 million from 90% in 2002 to 71% in 2006.²⁰⁸ See Figure 1.

litigation risk and the impact on concentration); Record of Proceedings (June 3, 2008) (Written Submission of Charles W. Gerdt, III, General Counsel, PricewaterhouseCoopers, LLP, 12), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Bedard060308.pdf> (suggesting that audited financial statements would not help audit quality, may harm competition, and could increase settlement awards); Record of Proceedings (June 3, 2008) (Written Submission of Kenneth Nielsen Goldmann, Capital Markets and SEC Practice Director, J.H. Cohn LLP, 5), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Goldmann060308.pdf> (stating that smaller firms would leave the public company audit market due to the fact that "they would view such disclosure as placing them in a negative competitive position with respect to larger audit firms, current and potential clients, and potential plaintiffs"); David McDonnell, Chief Executive Officer, Grant Thornton International Ltd, and Edward E. Nusbaum, Chief Executive Officer, Grant Thornton LLP, and Chairman, Grant Thornton International Ltd Board of Governors, Comment Letter Regarding Draft Report and Draft Report Addendum 5 (June 27, 2008), available at http://comments.treas.gov/_files/GTCommentLettertoACAPJune2008_FINAL.pdf (noting the lack of evidence that audit quality would improve but states that the Recommendation would have an adverse affect on concentration and smaller firms); Record of Proceedings (June 3, 2008) (Written Submission of Michael R. Young, Partner, Willkie Farr & Gallagher LLP, 4), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Young060308.pdf> (noting that the Recommendation may result in larger settlement demands).

²⁰⁶ U.S. Government Accountability Office, *Audits of Public Companies: Continued Concentration in Audit Market for Large Public Companies Does Not Call for Immediate Action*, GAO-08-163 (Jan. 2008) [hereinafter 2008 GAO Report].

Figure 1: Percentage of Companies Audited by Four Largest Auditing Firms, by Company Size



Source: U.S. GOVERNMENT ACCOUNTABILITY OFFICE, AUDITS OF PUBLIC COMPANIES: CONTINUED CONCENTRATION IN AUDIT MARKET FOR LARGE PUBLIC COMPANIES DOES NOT CALL FOR IMMEDIATE ACTION, GAO-08-163, Highlights (Jan. 2008).

The Committee considered the testimony of several witnesses regarding the reasons for the continued concentration in the large public company audit market. Auditing firms, public companies, market participants, academics, investors and others reasoned that large public companies with operations in multiple countries need auditing firms with global resources and technical and industry expertise to deal with an increasingly complex business and financial reporting environment.²⁰⁹ These needs limit auditor choice to only the largest auditing firms for many large public companies. The Committee heard from witnesses who also described barriers to the growth of smaller auditing firms, including the behavior of underwriters and other capital market participants.²¹⁰

In analyzing these data on concentration and limited auditor choice in the large public company audit market, the Committee focused on the potential negative impact of concentration on audit quality. Some have suggested the lack of competition may not provide sufficient incentive for the dominant auditing firms to deliver high quality and innovative audit

services.²¹¹ Notwithstanding the increasing number of public company financial restatements,²¹² the Committee heard from several witnesses that audit quality had improved.²¹³ For example, the GAO observed that market participants and public company officials had noted improvement in recent years in audit quality, including auditing firm staff's technical expertise, responsiveness to client needs, and ability to identify material financial reporting matters.²¹⁴ Much of the improvement was credited to the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley), which enhanced auditor independence, replaced the self-regulation of the auditing profession with the PCAOB, mandated evaluation and disclosure of the effectiveness of internal controls over financial

reporting,²¹⁵ and strengthened audit committee membership, independence, and responsibilities.

Although industry concentration can lead to increased prices, the Committee notes that the GAO concluded that higher audit market concentration has not been associated with higher fees. Public companies, auditing firms, and other market participants believe the considerable increase in audit fees in recent years is due not to market power of a concentrated industry, but to the increased requirements under Sarbanes-Oxley, the complexity of accounting and financial reporting standards, the need to hire and retain qualified audit staff, and the independence requirements (which have led to the possible re-pricing of audits to their unbundled market price).²¹⁶ The Committee also considered the impact of the possible loss of one of the four largest accounting firms in light of the high degree of concentration of public company auditing, and especially large public company auditing, in those firms. The GAO noted the possibility of this loss due to issues arising out of firm conduct, such as civil litigation, federal or state regulatory action or criminal prosecution, or economic events, such as a merger.²¹⁷ The GAO posited

²¹¹ 2008 GAO Report 31–32.

²¹² See, e.g., Susan Scholz, *The Changing Nature and Consequences of Public Company Financial Restatements 1997–2006* (Apr. 2008).

²¹³ 2008 GAO Report 5; Pub. Company Accounting Oversight Bd., *Report on the PCAOB's 2004, 2005, and 2006 Inspections of Domestic Triennially Inspected Firms*, PCAOB Rel. No. 2007–010 (Oct. 22, 2007).

²¹⁴ Record of Proceedings (Dec. 3, 2007) (Questions for the Record of Jeanette M. Franzel, Director, Financial Management and Assurance Team, U.S. Government Accountability Office, 2 (Jan. 30, 2008)), available at <http://www.treas.gov/offices/domestic-finance/acap/QFRs-12-3-2007.pdf> (observing that the market believes the “bar had been raised” on audit quality). See also Center for Audit Quality, *Report on the Survey of Audit Committee Members* (Mar. 2008) (concluding that: 17% of surveyed audit committee members view audit quality as good, 53% as very good, 25% as excellent, while 82% say overall quality has improved somewhat/significantly over the past several years).

²¹⁵ 2008 GAO Report 32.

²¹⁶ 2008 GAO Report 27–29. On the re-pricing of audits, see also James D. Cox, *The Oligopolistic Gatekeeper: The U.S. Accounting Profession, in After Enron: Improving Corporate Law and Modernizing Securities Regulation in Europe and the U.S.*, Chapter 9, Oxford, forthcoming, available at <http://ssrn.com/abstract=926360>.

²¹⁷ 2008 GAO Report 34–35.

²⁰⁷ GAO, *Public Accounting Firms: Mandated Study on Consolidation and Competition*, GAO–03–864 (July 2003) (finding that “although audits for large public companies were highly concentrated among the largest accounting firms, the market for audit services appeared competitive according to various indicators”).

²⁰⁸ 2008 GAO Report 19. The GAO also found that the largest firms collected 94% of all audit fees paid by public companies in 2006, slightly less than the 96% they collected in 2002. 2008 GAO Report 16.

potential negative effects of such a loss, including the following: Further limitations on large public company auditor choice, costs associated with changing auditors, and companies' inability to obtain timely financial statement audits.²¹⁸ However, the GAO did not recommend insulating auditing firms directly from either the legal or market consequences of their actions.

With the above considerations in mind, the Committee recommends that regulators, the auditing profession, and other bodies, as applicable, effectuate the following:

Recommendation 1. Reduce barriers to the growth of smaller auditing firms consistent with an overall policy goal of promoting audit quality. Because smaller auditing firms are likely to become significant competitors in the market for larger company audits only in the long term, the Committee recognizes that Recommendation 2 will be a higher priority in the near term.

The GAO concluded that concentration in the large public company audit market will not be reduced in the near term by smaller auditing firms. The Committee considered testimony regarding the reasons that smaller auditing firms are unable or unwilling to enter the large public company audit market. Challenges facing these firms' entry into this market typically include the following: Lack of staffing and geographic limitations on both the physical span of their practices and experience and expertise with global auditing complexities; inability to create global networks necessary to serve global clients, due to lack of auditing firms abroad to act as potential partners; the need for greater technical capability and industry specialization; lack of name recognition and reputation; and limited access to capital.²¹⁹ In addition, expanding into the large public company audit market may be unattractive for some smaller auditing firms for a variety of reasons,²²⁰

including increased exposure to litigation, the possibility that their business model is not scalable, and the fact that for some smaller firms other aspects of their business (such as private company auditing and other work) has greater potential for expansion.

To address these issues, the Committee recommends that policy makers press for the reduction of barriers, to the extent consistent with audit quality and other public interest factors, to the growth of smaller auditing firms. For smaller firms, this includes encouraging and promoting development of technical resources in such areas as international financial reporting standards (IFRS) and fair value accounting, and development of specialized or "niche" practices or industry "verticals" where they are in the best interests of investors and can lead to more effective competition. Pressure also should be applied against non-justifiable resistance to using smaller firms on the part of a variety of market actors.

Some commentary has also noted the costs associated with public companies' changing auditors and how these costs can pose another barrier for smaller firms trying to enter the larger public company audit market. For example, commentary and testimony noted the often high fees charged for the predecessor auditor's opinion on previously filed financial statements and the challenges associated with having the predecessor auditor transfer its work papers to the successor auditor.²²¹ Other obstacles to auditor changes discussed by the Committee have included poor communication between predecessor and successor auditors.

The Committee believes that public companies should not be limited in their auditor selection by unnecessary barriers created during the auditor change and selection processes. Consistent with AU 315: Communications Between Predecessor and Successor Auditors,²²² which addresses communications between predecessor and successor auditors, the

Committee urges the Securities and Exchange Commission (SEC) and the PCAOB to encourage predecessor auditors to fully communicate and cooperate with the successor auditors. This communication and cooperation should apply to all auditors regardless of their size. The issue of auditor changes and the importance of transparency in this area are addressed within Chapter V of this Report.

The Committee believes that the following specific and incremental actions would assist in the growth of the smaller firms and their entry into the large public company audit market:

(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.

The Committee considered testimony and commentary that certain market participants, such as underwriters, banks, and lenders, may influence and effectively limit public company auditor selection decisions.²²³ For instance, certain contractual arrangements limit public companies' auditor choice.²²⁴ Consistent with the large public company audit market, this practice is particularly prevalent in the initial public offering (IPO) arena, where an underwriter may include in the underwriting agreement a provision limiting the company's auditor choice to a specified group of auditing firms.²²⁵

²²³ See, e.g., Record of Proceedings (Feb. 4, 2008) (Written Submission of Edward E. Nusbaum, Chief Executive Officer, Grant Thornton LLP, and Chairman, Grant Thornton International Board of Governors, 3), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Nusbaum020408.pdf> (noting that transparency regarding "restrictive contracts with underwriters" could improve auditor choice). See also 2008 GAO Report 47.

²²⁴ See, e.g., Record of Proceedings (Dec. 3, 2007) (Written Submission of Lewis H. Ferguson, III, Partner, Gibson Dunn & Crutcher, 2), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Ferguson120307.pdf> ("Sometimes lenders, investors, investment bankers or credit rating agencies will insist that a company seeking to access the capital markets have its financial statements audited by one of the largest accounting firms, adding a bias that has the practical effect of being a barrier to entry.").

²²⁵ See, e.g., Record of Proceedings (May 5, 2008) (Oral Remarks of Committee Member Ken Goldman, Chief Financial Officer, Fortinet, Inc., 143), available at <http://www.treas.gov/offices/domestic-finance/acap/ agendas/minutes-05-05-08.pdf>. See also, Edwin J. Kliegman, CPA, Comment Letter Regarding Discussion Outline 2 (Nov. 26, 2007), available at http://comments.treas.gov/index.cfm?FuseAction=Home.View&Topic_id=9&FellowType_id=1&CurrentPage=2; Record of Proceedings (Feb. 4, 2008) (Oral Remarks of Brad Koenig, Former Managing Director and Head of Global Technology Investment Banking, Goldman Sachs, 219–220), available at <http://www.treas.gov/offices/domestic-finance/acap/Koenig020408.pdf> (noting underwriter practices in auditor selection).

²¹⁸ 2008 GAO Report 35–36.

²¹⁹ See, e.g., 2008 GAO Report 37; Record of Proceedings (Dec. 3, 2007) (Written Submission of Wayne Kolins, National Director of Assurance and Chairman, BDO Seidman LLP, 2), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Kolins120307.pdf> (describing as barriers for smaller auditing firms liability risks, overly complex independence rules, and an array of factors that audit committees may review in choosing an auditor that best matches the company); Record of Proceedings (Feb. 4, 2008) (Written Submission of Neal D. Spencer, Managing Partner, BKD, LLP, 1), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Spencer020408.pdf> (noting that barriers include resources, institutional bias, insurability, and liability).

²²⁰ 2008 GAO Report 38.

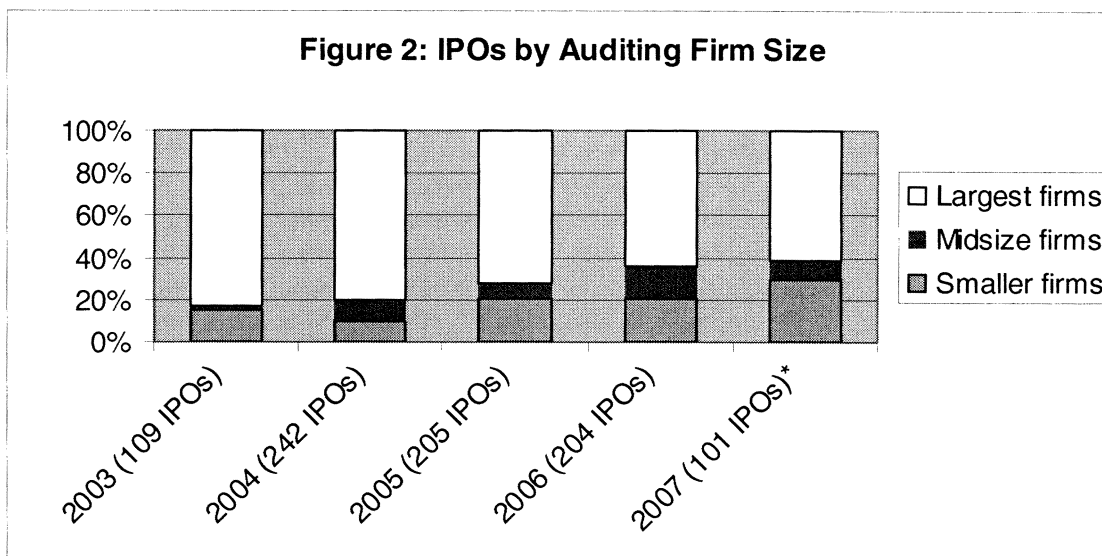
²²¹ Anonymous, Private Investor, Former Auditor, and Former CFO, Comment Letter Regarding Draft Report and Draft Report Addendum 1 (May 11, 2008), available at http://comments.treas.gov/index.cfm?FuseAction=Home.View&Topic_id=9&FellowType_id=1&CurrentPage=2; Record of Proceedings (June 3, 2008) (Questions 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>.

²²² Communications Between Predecessor and Successor Auditors, Interim Auditing Standard AU 315 (Pub. Company Accounting Oversight Bd. 2002).

Evidence suggests that auditor choice may be more limited among the largest IPOs: While midsize and smaller firms'

combined share of the IPO market (by number of IPOs) has increased progressively (rising from 18% in 2003

to 40% in 2007),²²⁶ the largest firms continue to audit the majority of the largest IPOs.²²⁷ See Figure 2.



*IPOs for 2007 are January through June.

Note: The largest firms – Deloitte & Touche LLP, Ernst & Young LLP, KPMG LLP, and PricewaterhouseCoopers LLP – each audited more than 1,200 public companies for 2006 according to Public Accounting Report. The midsize firms – BDO Seidman LLP, Crowe Chizek & Company LLC, Grant Thornton LLP, and McGladrey and Pullen LLP – each audited more than 100 but fewer than 425 public companies for 2006 and had around \$1 billion in revenue or less according to Public Accounting Report. Smaller firms include all other auditing firms.

Source: U.S. GOVERNMENT ACCOUNTABILITY OFFICE, AUDITS OF PUBLIC COMPANIES: CONTINUED CONCENTRATION IN AUDIT MARKET FOR LARGE PUBLIC COMPANIES DOES NOT CALL FOR IMMEDIATE ACTION, GAO-08-163, 46 (Jan. 2008).

The Committee believes these provisions impair competition by limiting public company auditor choice and the ability of smaller auditors to serve a greater share of the public company audit market. Accordingly, the Committee recommends that the SEC require public companies to disclose in their registration statements, annual

reports, and proxy statements any provisions in agreements limiting auditor choice.²²⁸ The disclosure should identify the agreement and include the names of the parties to the agreement and the actual provisions limiting auditor choice.²²⁹

(b) Include representatives of smaller auditing firms in committees, public

forums, fellowships, and other engagements.

The Committee considered testimony that the lack of smaller firms' name recognition and reputation have hindered smaller auditing firms' ability to compete in the large public company audit market. The GAO noted that name recognition, reputation, and credibility

²²⁶ 2008 GAO Report 44.

²²⁷ Record of Proceedings (Feb. 4, 2008) (Written Submission of Brad Koenig, Former Managing Director and Head of Global Technology Investment Banking, Goldman Sachs, 2), available at <http://www.treas.gov/offices/domestic-finance/acap/Koenig020408.pdf> (noting that from 2002–2007 the largest four auditing firms had an 87% market share of the 817 initial public offerings that exceeded \$20 million). See also 2008 GAO Report 44 (“Staff from some investment firms that underwrite stock issuances for public companies told [GAO] that in the past they generally had expected the companies for which they raised capital to use one of the largest firms for IPOs but that now these organizations were more willing to accept smaller audit firms. * * * However, * * * most of the companies that went public with a mid-size or smaller auditor were smaller. In addition, these firms' share of IPOs of larger companies (those with revenues greater than \$150 million) rose from none in 2003 to about 13 percent in 2007.”).

²²⁸ See, e.g., Record of Proceedings (June 3, 2008) (Written Submission of Jean C. Bedard, Timothy B. Harbert Professor of Accounting, Department of

Accountancy, Bentley College, 8), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Bedard060308.pdf> (supporting this Recommendation and noting that enhanced name recognition “would provide further incentives for these [smaller] firms to build the personnel quality of their organizations”); Wayne Kolins, National Director of Assurance and Chairman, BDO Seidman LLP, Comment Letter Regarding Draft Report and Draft Report Addendum 5, (June 27, 2008), available at http://comments.treas.gov/_files/ResponseToAdvisoryCommittee0627FINAL.pdf (recommending that “the SEC adopt a rule prohibiting agreements with third parties that limit auditor selection to specific firms, other than to specify that the firm selected must be suitably qualified to perform the audit”); David McDonnell, Chief Executive Officer, Grant Thornton International Ltd, and Edward E. Nusbaum, Chief Executive Officer, Grant Thornton LLP, and Chairman, Grant Thornton International Ltd Board of Governors, Comment Letter Regarding Draft Report and Draft Report Addendum 6 (June 27, 2008), available at http://comments.treas.gov/_files/GTCommentLettertoACAPJune2008_FINAL.pdf

(“Such public disclosure will create incentives for audit committees to optimize their auditor choice and help clarify that size alone is not the best criterion when selecting an auditor.”). But c.f., Record of Proceedings (June 3, 2008) (Written Submission of Brian O'Malley, Senior Vice President and General Auditor, Nasdaq Stock Market, 2), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/OMalley060308.pdf> (noting that disclosure may add transparency but the “root causes” of decisions to limit auditor choice remain).

²²⁹ The Committee notes that a group of market participants put together by the United Kingdom's Financial Reporting Council to study audit market competition has suggested similar disclosure of contractual obligations limiting auditor choice. See Financial Reporting Council, FRC Update: Choice in the UK Audit Market 4 (Apr. 2007) [hereinafter FRC Update] (recommending that “when explaining auditor selection decisions, Boards should disclose any contractual obligations to appoint certain types of audit firms”).

were significant barriers to smaller auditing firm expansion.²³⁰ The PCAOB has registered and oversees 982 U.S. auditing firms and 857 foreign auditing firms.²³¹ While it is not possible to include all smaller firms, the Committee received testimony and comment letters suggesting that there should be greater inclusion and participation of smaller firms in public and private sector committees, roundtables, and fellowships.²³² One auditing firm representative suggested the creation of a PCAOB professional practice fellowship program, reaching out to professionals from auditing firms of various sizes.²³³

The Committee believes increasing name recognition and reputation could promote audit market competition and auditor choice.²³⁴ Accordingly, the

²³⁰ 2008 GAO REPORT 44 (“Fifty percent of accounting firms responding to [GAO’s] survey that want to audit large companies said that name recognition or reputation with potential clients was a great or very great impediment to expansion. Similarly, 54 percent of these firms cited name recognition or credibility with financial markets and investment bankers as a great or very great impediment to expansion.”). See also Edward J. Kliegman, CPA, Comment Letter Regarding Discussion Outline (Nov. 16, 2007), available at http://comments.treas.gov/index.cfm?FuseAction=Home.View&Topic_id=3&FellowType_id=1.

²³¹ Data are as of Feb. 21, 2008.

²³² See, e.g., Andrew D. Bailey, Jr., Professor of Accountancy—Emeritus, University of Illinois, and Senior Policy Advisor, Grant Thornton LLP, Comment Letter Regarding Discussion Outline 16 (Jan. 30, 2008), available at <http://comments.treas.gov/files/BAILEYCOMMENTSONTREASURYADVISORYCOMMITTEEOUTLINEFINALSUBMISSION13008.doc>; Record of Proceedings (Dec. 3, 2007) (Questions for the Record of James S. Turley, Chairman and Chief Executive Officer, Ernst & Young LLP, 4 (Feb. 1, 2008)), available at <http://www.treas.gov/offices/domestic-finance/acap/QFRs-12-3-2007.pdf>.

²³³ Record of Proceedings (Dec. 3, 2007) (Written Submission of Wayne Kolins, National Director of Assurance and Chairman, BDO Seidman LLP, 4), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Kolins120307.pdf>. See Chapter IV (recommending the creation of a PCAOB fellowship program). While maintenance and extension of professional fellowship programs are also considered in the Committee’s recommendations relating to human capital matters, extending these opportunities increasingly to firms of various sizes could assist smaller firms in their ability to compete in the public company audit market.

²³⁴ See, e.g. Record of Proceedings (June 3, 2008) (Written Submission of Jean C. Bedard, Timothy B. Harbert Professor of Accounting, Department of Accountancy, Bentley College, 8), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Bedard060308.pdf> (agreeing with the Recommendation); Record of Proceedings (June 3, 2008) (Written Submission of Kenneth Nielsen Goldmann, Capital Markets and SEC Practice Director, J.H. Cohn LLP, 4), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Goldmann060308.pdf> (“More opportunities such as this testimony for leaders of smaller firms to participate in important public policy discussions about the public company audit profession would over time enhance public

Committee recommends that regulators and policy makers, such as the SEC, the PCAOB, and the Financial Accounting Standards Board (FASB), include representatives of smaller auditing firms in committees, public forums, fellowships, and other engagements.²³⁵ The Committee recognizes the existence of different programs within regulatory agencies available to serve as a resource and contact point for smaller auditing firms and smaller public companies, such as, the SEC’s Office of Small Business Policy, the PCAOB’s Forum on Auditing in the Small Business Environment, and the FASB’s Small Business Advisory Committee.

Recommendation 2. Monitor potential sources of catastrophic risk faced by public company auditing firms and create a mechanism for the preservation and rehabilitation of troubled larger public company auditing firms.

The Committee considered testimony regarding the variety of potentially catastrophic risks that public company auditing firms face. These risks include general financial risks and risks relating to failure in the provision of audit services and non-audit services, including civil litigation, regulatory actions, and loss of customers, employees, or auditing network partners due to a loss of reputation.²³⁶

The Committee believes these risks are real and notes that over the past two decades two large auditing firms have gone out of existence. In 1990, Laventhol & Horwath, at the time the seventh largest auditing firm in the

understanding and acceptance that high quality in auditing is achievable in different forms and packages.”); Record of Proceedings (June 3, 2008) (Written Submission of Kurt N. Schacht, Managing Director, Centre for Financial Market Integrity, CFA Institute, 2–3), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Schacht060308.pdf>.

²³⁵ For a similar recommendation, see SEC Advisory Committee on Smaller Public Companies, Final Report 114 (Apr. 23, 2006).

²³⁶ See, e.g., 2008 GAO Report 32–36; Zoe-Vonna Palmrose, Maintaining the Value and Viability of Independent Auditors as Gatekeepers under SOX: An Auditing Master Proposal, in Brookings-Nomura Seminar: After the Horses Have Left the Barn: the Future Role of Financial Gatekeepers 12–13 (Sept. 28, 2005). Civil litigation was the risk most often cited by witnesses before the Committee. See, e.g., Record of Proceedings (Dec. 3, 2007) (Written Submission of James D. Cox, Brainerd Currie Professor of Law, Duke University School of Law), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Cox120307.pdf>. See also Eric R. Talley, Cataclysmic Liability Risk among Big Four Auditors, 106 Colum. L. Rev. 1641 (Nov. 2006) (“On one hand, the pattern of liability exposure during the last decade does not appear to be the type that would, at least on first blush, imperil the entire profession. On the other hand, if one predicts historical liability exposure patterns into the future, the risk of another firm exiting due to liability concerns appears to be more than trivial.”).

United States, filed for bankruptcy protection due in part to a failure in the provision of non-audit services, and subsequent class action litigation, loss of reputation, and inability to attract and retain clients.²³⁷ In 2002, Arthur Andersen, at the time one of the five largest auditing firms in the United States, dissolved. The Department of Justice (DOJ) had criminally indicted the auditing firm on obstruction of justice charges relating to the audit of Enron. The resulting inability to retain clients and partners and keep together its global affiliate network led to the collapse of Arthur Andersen.²³⁸

In addition, KPMG recently faced the possibility of criminal indictment relating to its provision of tax-related services. In the end, KPMG entered into a deferred prosecution agreement with the DOJ.²³⁹ Many have suggested that a criminal indictment would have led to the dissolution of the firm.

Currently, BDO Seidman is appealing a \$521 million state judgment involving a private company audit client. The auditing firm’s chief executive has publicly stated that such a judgment amount would threaten the firm’s viability.²⁴⁰

As discussed above, the Committee believes that the loss of one of the larger auditing firms would likely have a significant negative impact on the capital markets. Of greatest concern is the potential disruption to capital markets that the failure of a large auditing firm would cause, due to the lack of sufficient capacity to audit the largest public companies and the possible inability of public companies to obtain timely audits.²⁴¹ The

²³⁷ See, e.g. 2008 GAO Report 33.

²³⁸ See, e.g., U.S. Government Accountability Office, Public Accounting Firms: Mandated Study on Consolidation and Competition 12 (July 2003) (“The criminal indictment of fourth-ranked Andersen for obstruction of justice stemming from its role as auditor of Enron Corporation led to a mass exodus of Andersen partners and staff as well as clients.”).

²³⁹ 2008 GAO Report 56–57, n. 60. Note that the Department of Justice did indict several individuals.

²⁴⁰ Jury Awards Rise Against BDO Seidman, Assoc. Press, Aug. 15, 2007.

²⁴¹ See 2008 GAO Report 35, 36 (observing that further audit market concentration would “leave large companies with potentially only one or two choices for a new auditor” and that “the market disruption caused by a firm failure or exit from the market could affect companies’ abilities to obtain timely audits of their financial statements, reducing the audited financial information available to investors”). See also London Economics, Final Report to EC–DG Internal Market and Services, Study on the Economic Impact of Auditors’ Liability Regimes 24 (Sept. 2006) (“The adjustment to a situation in which one of the Big-4 networks fails is unlikely to be smooth. But the long run consequences are likely to be limited provided the overall statutory audit capacity does not fall

Committee believes these concerns must be balanced against the importance of auditing firms and their partners, as private, for-profit businesses, being exposed to the consequences of failure, including both the legal consequences and economic consequences.

In consideration of these competing concerns, the Committee makes the following recommendations:

(a) As part of its current oversight over registered auditing firms, the PCAOB should monitor potential sources of catastrophic risk which would threaten audit quality.

The PCAOB's mission is to oversee auditing firms conducting audits of public companies. Its audit quality-focused mission is intertwined with issues of catastrophic risk, as most often risks to firms' survival historically have been largely the result of significant audit quality failures or serious compliance issues in the non-audit services aspect of their business.

Sarbanes-Oxley provides the PCAOB with registration, reporting, inspection, standard-setting, and enforcement authority over public company auditing firms.²⁴² Under its inspection authority, the PCAOB inspects audit engagements, evaluates quality control systems, and tests as necessary audit, supervisory, and quality control procedures. For example, in its inspection of an auditing firm's quality control systems, the PCAOB reviews the firm's policies and procedures related to partner evaluation, partner compensation, new partner nominations and admissions, assignment of responsibilities, disciplinary actions, and partner terminations; compliance with independence requirements; client acceptance and retention policies and procedures; compliance with professional requirements regarding consultations on accounting, auditing, and SEC matters; internal inspection program; processes for establishing and communicating audit policies, procedures, and methodologies; processes related to review of a firm's foreign affiliate's audit performance; and tone at the top.²⁴³

significantly. Among the various economic sectors, financial institutions may find such a situation particularly difficult as their statutory audits are viewed as more risky and * * * two Big-4 firms dominate the market for statutory audits of financial institutions. The situation is likely to be much direr if a second Big-4 network fails shortly after the first one. Investors' confidence will be in all likelihood seriously affected and the adjustment to the new situation is likely to be difficult.”)

²⁴² Sarbanes-Oxley Act of 2002, 15 U.S.C. §§ 7211–7219.

²⁴³ See, e.g., PCAOB, Observations on the Initial Implementation of the Process for Addressing Quality Control Criticisms within 12 Months after

The PCAOB also has authority to require registered auditing firms to provide annual and periodic reports. In May 2006, the PCAOB issued Proposed Rules on Periodic Reporting by Registered Public Accounting Firms requiring annual and periodic reporting.²⁴⁴ The PCAOB has not yet finalized this proposal.

The Committee therefore recommends that the PCAOB, in furtherance of its objective to enhance audit quality and effectiveness, exercise its authority to monitor meaningful sources of catastrophic risk that potentially impact audit quality through its programs, including inspections, registration and reporting, or other programs, as appropriate.²⁴⁵ The objective of PCAOB monitoring would be to alert the PCAOB to situations in which auditing firm conduct is resulting in increased catastrophic risk which is impairing or threatens to impair audit quality.²⁴⁶

(b) Establish a mechanism to assist in the preservation and rehabilitation of a troubled larger auditing firm. A first step would encourage larger auditing firms to adopt voluntarily a contingent streamlined internal governance mechanism that could be triggered in the event of threatening circumstances.

an Inspection Report, PCAOB Release No. 104–2006–078 (Mar. 21, 2006). See also the PCAOB's completed inspection reports at http://www.pcaobus.org/Inspections/Public_Reports/index.aspx#k.

²⁴⁴ PCAOB Release No. 2006–004 (May 23, 2006).

²⁴⁵ See, e.g., Record of Proceedings (June 3, 2008) (Oral Remarks of James Kaplan, Chairman and Founder, Audit Integrity, 280–283), available at <http://www.treas.gov/offices/domestic-finance/acap/agentas/minutes-06-03-08.pdf> (noting that “it really only requires one or two catastrophic events in order to upset or disturb the market place. And clearly, more information needs to be gathered and collected to ensure, or at least assure, that the number of tragic incidents like that are minimized and mitigated”); Record of Proceedings (June 3, 2008) (Written Submission of Brian O'Malley, Senior Vice President and General Auditor, Nasdaq Stock Market, 2–3), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/OMalley060308.pdf> (supporting this Recommendation); Record of Proceedings (June 3, 2008) (Written Submission of Kurt N. Schacht, Managing Director, Centre for Financial Market Integrity, CFA Institute, 3), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Schacht060308.pdf> (supporting this Recommendation).

²⁴⁶ See, e.g., Record of Proceedings (June 3, 2008) (Written Submission of Jean C. Bedard, Timothy B. Harbert Professor of Accounting, Department of Accountancy, Bentley College, 9), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Bedard060308.pdf> (supporting this Recommendation); Record of Proceedings (June 3, 2008) (Written Submission of Charles W. Gerds, III, General Counsel, PricewaterhouseCoopers, LLP, 8), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Bedard060308.pdf> (stating that the “concept” behind this Recommendation deserves serious consideration).

If the governance mechanism failed to stabilize the firm, a second step would permit the SEC to appoint a court-approved trustee to seek to preserve and rehabilitate the firm by addressing the threatening situation, including through a reorganization, or if such a step were unsuccessful, to pursue an orderly transition.

The Committee considered testimony regarding the importance of the viability of the larger auditing firms and the negative consequences of the loss of one of these firms on the capital markets. The Committee also considered commentary regarding issues auditing firms faced in addressing circumstances that threatened their viability, including, in particular, problems arising from the need to work with regulators and law enforcement agencies.²⁴⁷ Several witnesses suggested the development of a mechanism to allow auditing firms facing threatening circumstances to emerge from those situations.²⁴⁸ Committee member and former Federal Reserve Chairman Paul Volcker opined that, “[I]f we had [such an] arrangement at the time Andersen went down, we would have saved it.”²⁴⁹ The Committee notes that it is critical to have a process in place to quickly respond to crisis events and

²⁴⁷ See, e.g., Securities and Exchange Commission, Temporary Final Rule and Final Rule: Requirements for Arthur Andersen LLP Auditing Clients, SEC Release No. 33–8070 (Mar. 18, 2002); Securities and Exchange Commission, Press Rel. No. 2002–39 and Order Rel. No. 33–8070 (Mar. 18, 2002) (indictment of Arthur Andersen); SEC Staff Accounting Bulletin No. 90 (Feb. 7, 1991) (bankruptcy of Laventhol & Horwath).

²⁴⁸ Record of Proceedings (Dec. 3, 2007) (Written Submission of James R. Doty, Partner, Baker Botts L.L.P., 11–13), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Doty120307.pdf> (suggesting that the Bankruptcy Code be amended to prevent creditors whose claims relate to violations of professional standards from opposing reorganization under a court-approved plan; an automatic stay against partners facilitating partner retention; expanding the SEC's emergency powers to enable the SEC to act by summary order to address the registered firm's ability to continue to provide audit services; and encouraging the SEC or PCAOB to discourage “client poaching” by requiring public companies to show that switching auditors was not related to mega-judgments against audit affiliates in other jurisdictions). See also Record of Proceedings (Dec. 3, 2007) (Written Submission of Peter S. Christie, Principal, Friemann Christie, LLC, 6), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Christie120307.pdf> (“If it remains possible that a firm can fail for reasons other than liability claims it may be attention needs to be given to devices that will permit a firm to re-emerge.”).

²⁴⁹ Record of Proceedings (Mar. 13, 2008) (Oral Remarks of Paul A. Volcker, Former Chairman, Board of Governors, Federal Reserve System, 317), available at <http://www.treas.gov/offices/domestic-finance/acap/agentas/minutes-03-13-08.pdf>.

recommends the following two-step mechanism described below.

First Step—Internal Governance Mechanism

The Committee notes that auditing firms operate as partnerships, generally led by a centralized management team, with a supervisory board of partners overseeing management's strategy and performance.²⁵⁰ In the event of threatening circumstances at a larger auditing firm, the Committee believes that a lack of effective centralized governance mechanisms may delay crucial decision making, impede difficult decisions that could sustain the firm and its human assets, and lessen the firm's ability to communicate with maximum responsiveness and effectiveness with private, regulatory and judicial bodies.

The Committee therefore recommends that larger auditing firms (those with 100 or more public company audit clients that the PCAOB inspects annually) establish in their partnership agreements a contingent internal governance mechanism, involving the creation of an Executive Committee (made up of partners or outsiders) with centralized firm management powers to address threatening circumstances. The centralized governance mechanism would have full authority to negotiate with regulators, creditors, and others, and it would seek to hold the firm's organization intact, including preserving the firm's reputation, until the mitigation of the threat, or, failing that, the implementation of the second step outlined below. The auditing firm voluntarily would trigger the operation of this mechanism upon the occurrence of potentially catastrophic events specified in the partnership agreement, such as civil litigation or actual or significantly threatened government or regulatory action. If necessary, the SEC and the PCAOB could encourage the firm to trigger the mechanism through private communications, public statements, or other means. Regulators could also assist in maintaining the firm's organization intact by, for example, increasing the time period for registrants that are audit clients to have audits or reviews completed and providing accelerated consultative guidance to registrants that are audit clients.²⁵¹ The Committee recognizes

²⁵⁰ Center for Audit Quality, Report of the Major Public Company Audit Firms to the Department of the Treasury Advisory Committee on the Auditing Profession 13 (Jan. 23, 2008).

²⁵¹ See, e.g., Securities and Exchange Commission, Temporary Final Rule and Final Rule: Requirements for Arthur Andersen LLP Auditing Clients, SEC Release No. 33-8070 (Mar. 18, 2002);

the precise details of such a mechanism would vary from auditing firm to auditing firm, depending on firm structures, history, and culture.²⁵²

Second Step—External Preservation Mechanism

The Committee also recommends that the larger auditing firms establish in their partnership agreements a rehabilitation mechanism under SEC oversight. The failure of the internal governance mechanism to preserve the auditing firm outlined in the first step above would trigger this second step, which would require legislation. Upon triggering of the second step, either voluntarily by the firm or by the SEC, the SEC would appoint a trustee, subject to court approval, whose mandate would be to seek to address the circumstances that threaten survival, and failing that, to pursue a reorganization that preserves and rehabilitates the firm to the extent practicable, and finally, if reorganization fails, to pursue an orderly transition.²⁵³ If this second mechanism is to include an element that addresses claims of creditors (which could include investors with claims,

Securities and Exchange Commission, Press Rel. No. 2002-39 and Order Rel. No. 33-8070 (Mar. 18, 2002) (indictment of Arthur Andersen); SEC Staff Accounting Bulletin No. 90 (Feb. 7, 1991) (bankruptcy of Laventhol & Horwath).

²⁵² Note that some commenters sought more prescription surrounding the implementation of this mechanism. See, e.g., Record of Proceedings (June 3, 2008) (Written Submission of Jean C. Bedard, Timothy B. Harbert Professor of Accounting, Department of Accountancy, Bentley College, 9), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Bedard060308.pdf> (recommending that the SEC and/or the PCAOB be granted the power to "require a firm to invoke its internal governance mechanism or to directly invoke the external preservation mechanism when particularly severe threats arise"); Deloitte LLP, Comment Letter Regarding Draft Report and Draft Report Addendum 27-29 (June 27, 2008), available at http://comments.treas.gov/_files/DeloitteLLPCommentLetter.pdf (stating that "the only effective way to stave off disaster is to ensure that the threat itself is mitigated at its source"); Cynthia Fornelli, Executive Director, Center for Audit Quality, Comment Letter Regarding Draft Report and Draft Report Addendum 34-35 (June 27, 2008), available at http://comments.treas.gov/_files/CAQCommentLetter62708FINAL.pdf; Record of Proceedings (June 3, 2008) (Written Submission of Barry Mathews, Deputy Chairman, Aon Corporation, 1), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Mathews060308.pdf>.

²⁵³ Some witnesses questioned whether the SEC would be willing to assume such a role. See, e.g., Record of Proceedings (June 3, 2008) (Written Submission of Charles W. Gerdts, III, General Counsel, PricewaterhouseCoopers, LLP, 9), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Gerdts060308.pdf> (noting that the SEC may not have the resources, expertise, or will to assume such a role).

audit and other clients, partners, other employees, and others), legislation to integrate this mechanism with the judicial bankruptcy process may be necessary.

It is important that this mechanism not be used as insurance for partner capital; that is, this mechanism should not be developed to "bail out" a larger auditing firm, but rather to preserve and rehabilitate the firm in order to ensure the stable functioning of the capital markets and the timely delivery of audited financial statements to investors and other financial statement users. Accordingly, there must be powers that can be exercised in furtherance of the objective of holding the firm together.²⁵⁴

In addition, the Committee recommends that, in order for the SEC to make effective and timely use of its powers under this Recommendation and for the DOJ to have the opportunity to be informed as to the consequences that would result from a potential charging decision against a public auditing firm (as distinct from individuals within a firm), the DOJ should inform the SEC prior to bringing criminal charges against such a firm.

The Committee also notes that the larger auditing firms are members or affiliates of global networks of firms and rely on these networks to serve their global clients. Since the networks are maintained through voluntary contractual agreements, the fact that a U.S.-based firm may be facing threatening circumstances could lead to the disintegration of the network. In this regard, in developing this mechanism, auditing firms, regulators, policy makers, and other market participants must consider the practical implications resulting from the relationship between the U.S.-based firms and the global networks.

Recommendation 3. Recommend the PCAOB, in consultation with auditors, investors, public companies, audit committees, boards of directors, academics, and others, determine the feasibility of developing key indicators of audit quality and effectiveness and requiring auditing firms to publicly disclose these indicators. Assuming development and disclosure of indicators of audit quality are feasible,

²⁵⁴ Record of Proceedings (Dec. 3, 2007) (Written Submission of James R. Doty, Partner, Baker Botts L.L.P., 11), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Doty120307.pdf> (Dec. 3, 2007) ("It is an anecdotal but firmly held perception of the profession that no accounting firm has entered bankruptcy and emerged to continue its practice. The hard assets of the firm are not significant: the professionals and the clients are the lifeblood of the registered firm. With any anticipation of bankruptcy, these mobile assets are gone.")

require the PCAOB to monitor these indicators.

A key issue in the public company audit market is what drives competition for audit clients and whether audit quality is the most significant driver. Currently, there is minimal publicly available information regarding indicators of audit quality at individual auditing firms. Consequently, it is difficult to determine whether audit committees, who ultimately select the auditor, and management are focused and have the tools that are useful in assessing audit quality that would contribute to making the initial auditor selection and subsequent auditor retention evaluation processes more informed and meaningful.²⁵⁵ In addition, with the majority of public companies currently putting shareholder ratification of auditor selection to an annual vote, shareholders may also lack audit quality information important in making such a ratification decision.²⁵⁶

The Committee believes that requiring firms to disclose indicators of audit quality may enhance not only the quality of audits provided by such firms, but also the ability of smaller auditing firms to compete with larger auditing firms, auditor choice, shareholder decision-making related to ratification of auditor selection, and PCAOB oversight of registered auditing firms.

The Committee recognizes the challenges of developing and monitoring indicators of audit quality, especially in light of the complex factors driving the potential impact on the incentives of market actors, and the resulting effect on competitive dynamics among auditors.²⁵⁷

The Committee has considered testimony and comment letters as well as other studies and reports in developing this recommendation. A possible framework for PCAOB consideration is reviewing annual

²⁵⁵ See, e.g., New York Stock Exchange, Listed Company Manual § 303A, which the SEC approved on November 4, 2003, for the responsibilities of exchange-listed companies' audit committees.

²⁵⁶ Institutional Shareholder Services, U.S. Corporate Governance Policy—2007 Updates 3 (2006).

²⁵⁷ If the idea proves to be workable, implementation could be a major undertaking for the PCAOB. Developing meaningful quality indicators, defining how they should be measured, and rolling out the measurement process could take significant PCAOB time and effort. Auditing firms, public companies, investors, and academics would all likely have valuable ideas as to approaches the PCAOB could take. However the indicators were devised, firms would have to build their internal processes for measuring the audit quality indicators and the PCAOB would have to develop procedures and training to monitor those processes.

auditing firm reports in other jurisdictions. For example, one auditing firm's United Kingdom affiliate lists in its annual report nine "key performance indicators, including average headcount, staff turnover, diversity, client satisfaction, audit and non-audit work, proposal win rate, revenue, profit, and profit per partner."²⁵⁸ The Financial Reporting Council recently published a paper setting out drivers of audit quality.²⁵⁹ In addition, the PCAOB also could consider some of the factors that auditing firms present to audit committees, such as engagement team composition, the nature and extent of firm training programs, and the nature and reason for client restatements.²⁶⁰

The Committee therefore recommends that the PCAOB, in consultation with auditors, investors, public companies, audit committees, boards of directors, academics, and others, determine the feasibility of developing key indicators of audit quality and requiring auditing firms to publicly disclose these indicators.²⁶¹ Testimonies and comment letters have suggested specific output-based audit quality indicators—indicators determined by what the auditing firm has produced in terms of its audit work, such as number of frauds discovered and nature and reason for financial restatements related to time periods when the underlying reason for restatement occurred during the auditing firm's tenure as auditor for the client- and input-based audit quality indicators—indicators of what the auditing firm puts into its audit work to achieve a certain result, such as the auditing firm's processes and

²⁵⁸ See KPMG LLP, UK Annual Report 2007 46.

²⁵⁹ FRC Update 4.

²⁶⁰ Record of Proceedings (Dec. 3, 2007) (Written Submission of Wayne Kolins, National Director of Assurance and Chairman, BDO Seidman LLP, 4), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Kolins120307.pdf>.

²⁶¹ See, e.g., Deloitte LLP, Comment Letter Regarding Draft Report and Draft Report Addendum 29, (June 27, 2008), available at http://comments.treas.gov/_files/DeloitteLLPCommentLetter.pdf; Ernst & Young LLP, Comment Letter Regarding Draft Report and Draft Report Addendum 33–34, (June 27, 2008), available at http://comments.treas.gov/_files/EYACAPCommentLetterFINAL.pdf; Cynthia Fornelli, Executive Director, Center for Audit Quality, Comment Letter Regarding Draft Report and Draft Report Addendum 36–38, (June 27, 2008), available at http://comments.treas.gov/_files/CAQCommentLetter62708FINAL.pdf (noting that the feasibility study should state the overarching objectives of quality indicators, consider the differences in firm size, partnership model, audit practice scope and audit specialty, and recognize the costs, difficulty and complexity involved); Record of Proceedings (June 3, 2008) (Written Submission of Kenneth Nielsen Goldman, Capital Markets and SEC Practice Director, J.H. Cohn LLP, 4), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Goldmann060308.pdf>.

procedures used for detecting fraud, the average experience level of auditing firm staff on individual engagements, the average ratio of auditing firm professional staff to auditing firm partners on individual engagements, and annual staff retention.²⁶² The Committee believes that the PCAOB should consider both output-based and input-based indicators.²⁶³ The

²⁶² See, e.g., Anonymous Retired Big 4 partner, Comment Letter Regarding Discussion Outline (Nov. 2007) (recommending public disclosure of the following audit quality drivers: (1) Average years of experience of audit professionals, (2) ratio of professional staff to audit partners, (3) chargeable hours per audit professional, (4) professional chargeable hours managed per audit partner, (5) annual professional staff retention, and (6) average annual training hours per audit professional); Matthew J. Barrett, Professor of Law, Notre Dame Law School, Comment Letter Regarding Draft Report and Draft Report Addendum (June 13, 2008), available at http://comments.treas.gov/index.cfm?FuseAction=Home.View&Topic&_id=9&FellowType&_id=1&CurrentPage=1; Dennis Johnson, CFA, Senior Portfolio Manager, CalPERS, Comment Letter Regarding Draft Report and Draft Report Addendum 3, (June 13, 2008), available at http://comments.treas.gov/_files/200806_13ACAP_addendum_commentltr.pdf (suggesting to include, among other things, "average headcount, staff turnover, diversity, client satisfaction, audit and non-audit work, proposal win rate, revenue, profit, profit per partner, engagement team composition, the nature and extent of training programs and the nature and reason for client restatements"); Record of Proceedings (Dec. 3, 2007) (Written Submission of Wayne Kolins, National Director of Assurance and Chairman, BDO Seidman LLP, 4), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Kolins120307.pdf> (recommending the issuance of regulatory guidance on qualitative factors to be used by audit committees and other market participants to evaluate auditing firms); Record of Proceedings (Dec. 3, 2007) (Written Submission of Dennis M. Nally, Chairman and Senior Partner, PricewaterhouseCoopers LLP, 6), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Nally120307.pdf> (suggesting that disclosure of "key elements that drive audit quality would be a useful benefit to the capital markets" and could include "firm disclosure and discussion of the levels of partner and staff turnover, average hours of professional training, risk management and compliance measurements, and metrics related to the quality of management and firm governance processes"); Anonymous Private Investor, Former Auditor, and Former CFO, Comment Letter Regarding Draft Report and Draft Report Addendum (May 11, 2008), available at http://comments.treas.gov/index.cfm?FuseAction=Home.View&Topic&_id=9&FellowType&_id=1&CurrentPage=2 (recommending that the auditor's report disclose, in addition to the location of the office conducting the audit, the percentage of office revenue attributed to the client, the length of the audit firm's tenure with the client, and the length of time until the lead and concurring partner must rotate).

²⁶³ See, e.g., Matthew J. Barrett, Professor of Law, Notre Dame Law School, Comment Letter Regarding Draft Report and Draft Report Addendum (June 13, 2008), available at http://comments.treas.gov/index.cfm?FuseAction=Home.View&Topic&_id=9&FellowType&_id=1&CurrentPage=1 (suggesting that the SEC require registrants to publicly disclose any financial fraud uncovered by the auditor, including numbers and amount of all audit adjustments, and the number of restatements of financial statements

Committee also recommends that, if the proposal is feasible, the PCAOB, through its inspection process, should monitor these indicators.

Recommendation 4. Promote the understanding of and compliance with auditor independence requirements among auditors, investors, public companies, audit committees, and boards of directors, in order to enhance investor confidence in the quality of audit processes and audits.

The Committee considered testimony and comment letters regarding the significance of the independence of the public company auditor—both in fact and appearance—to the credibility of financial reporting, investor protection,

with unqualified opinions); Joseph V. Carcello, Chair, AAA Task Force to Monitor the Activities of the Treasury ACAP Ernst & Young Professor and Director of Research—Corporate Governance Center University of Tennessee, Jean C. Bedard Timothy B. Harbert Professor of Accounting Bentley College, Dana R. Hermanson Dinos Eminent Scholar Chair of Private Enterprise and Professor of Accounting Kennesaw State University, Comment Letter Regarding Draft Report and Draft Report Addendum 10 (May 15, 2008), available at http://comments.treas.gov/_files/ACAPCommentLetterMay152008.pdf (suggesting that the Committee consider “output-based measures of audit quality” such as fewer client frauds, fewer client restatements, less earnings management, and more accurate auditor reporting before a bankruptcy filing); Record of Proceedings (Dec. 3, 2007) (Written Submission of Wayne Kolins, National Director of Assurance and Chairman, BDO Seidman LLP, 2), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Kolins120307.pdf>; Gilbert F. Viets, Comment Letter Regarding Draft Report and Draft Report Addendum 2–3, (May 19, 2008), available at http://comments.treas.gov/_files/TREASURYLETTER3.doc (suggesting disclosure of instances where the auditor found and corrected, prior to their disclosure, material financial statement errors and the firms’ “acceptable audit risk” in discovering material errors). The Committee recognizes the concerns noted by certain testimony and commentary regarding the use of audit quality indicators. See, e.g., Cynthia M. Fornelli, Executive Director, Center for Audit Quality, Comment Letter Regarding Draft Report and Draft Report Addendum 37 (June 27, 2008), available at http://comments.treas.gov/_files/CAQCommentLetter62708FINAL.pdf (“Any feasibility study should also consider—as the [UK’s Financial Reporting Council] has recognized—how the key indicators being considered may vary due to factors unrelated to audit quality.”); Wayne Kolins, National Director of Assurance and Chairman, BDO Seidman, LLP, Comment Letter Regarding Draft Report and Draft Report Addendum 11 (June 27, 2008), available at http://comments.treas.gov/_files/ResponseToAdvisoryCommittee0627final.PDF (“Disclosure of indicators would only be meaningful if they have a clear and demonstrable relationship to audit quality and, even if they do, only if they can be understood in the context of a particular audit.”); Record of Proceedings (June 3, 2008) (Written Submission of Brian O’Malley, Senior Vice President and General Auditor, Nasdaq Stock Market, 3), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/OMalley060308.pdf> (cautioning against an auditing industry managing itself towards some set of preconceived metrics that might sway them from investor protection).

and the capital formation process.²⁶⁴ The auditor is expected to offer critical and objective judgment on the financial matters under consideration, and actual and perceived absence of conflicts is critical to that expectation.

The Committee believes that auditors, investors, public companies, and other market participants must understand the independence requirements and their objectives, and that auditors must adopt a mindset of skepticism when facing situations that may compromise their independence. In that regard, the Committee makes the following recommendations:

(a) Compile the SEC and PCAOB independence requirements into a single document and make this document website accessible. The American Institute of Certified Public Accountants (AICPA) and state boards of accountancy should clarify and prominently note that differences exist between the SEC and PCAOB standards (applicable to public companies) and the AICPA and state standards (applicable in all circumstances, but subject to SEC and PCAOB standards, in the case of public companies) and indicate, at each place in their standards where differences exist, that stricter SEC and PCAOB independence requirements applicable to public company auditors may supersede or supplement the stated requirements. This compilation should not require rulemaking by either the SEC or the PCAOB because it only calls for assembly and compilation of existing rules.

In the United States, various oversight bodies have authority to promulgate independence requirements, including the SEC and PCAOB for public company auditors, and the AICPA and state boards of accountancy for public and private company auditors.²⁶⁵ The

²⁶⁴ See, e.g., Record of Proceedings (Dec. 3, 2007) (Written Submission of Dennis M. Nally, Chairman and Senior Partner, PricewaterhouseCoopers LLP, 5), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Nally120307.pdf> (“Independence forms the bedrock of credibility in the auditing profession, and is essential to the firms’ primary function in the capital markets.”); Record of Proceedings (Feb. 4, 2008) (Written Submission of Edward E. Nusbaum, Chief Executive Officer, Grant Thornton LLP, and Chairman, Grant Thornton International Board of Governors, 3), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Nusbaum020408.pdf>.

²⁶⁵ See, e.g., SEC Regulation S–X, Article 2, Rule 2–01—Qualifications of Accountants, 17 CFR § 210.2–01; SEC Financial Reporting Policies, Sec. 602.01—Interpretations Relating to Independence; SEC Final Rule, Amendments to SEC Auditor Independence Requirements “Strengthening the Commission’s Requirements Regarding Auditor Independence”, SEC Rel. No. 33–8183 (2003); SEC Final Rule, Revision of the Commission’s Auditor Independence Requirements, SEC Rel. No. 33–7919

Committee recommends that the SEC and PCAOB compile and publish their independence requirements in a single document and make this document easily accessible on their websites.²⁶⁶ The Committee recommends that the AICPA and state boards of accountancy clarify and prominently state that differences exist between their standards and those of the SEC and the PCAOB and indicate, at each place in their standards where differences exist, that additional SEC and PCAOB independence requirements applicable to public company auditors may supersede or supplement the stated requirements.²⁶⁷

(2001); PCAOB, Interim Independence Standards, ET Sections 101 and 191; Independence Standards Board, Independence Standards Nos. 1, 2, and 3, and ISB Interpretations 99–01, 00–1, and 00–2; PCAOB Bylaws and Rules, Section 3, Professional Standards; AICPA Code of Professional Conduct, ET Sections 100–102.

²⁶⁶ See, e.g., Cynthia Fornelli, Executive Director, Center for Audit Quality, Comment Letter Regarding Draft Report and Draft Report Addendum 38–39, (June 26, 2008), available at http://comments.treas.gov/_files/CAQCommentLetter62708FINAL.pdf (agreeing that “such a document would make it easier for auditors to understand the independence requirements that apply to them”); Record of Proceedings (June 3, 2008) (Written Submission of Brian O’Malley, Senior Vice President and General Auditor, Nasdaq Stock Market, 3), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/OMalley060308.pdf> (stating that the Recommendation would be a “great asset”); PricewaterhouseCoopers, Comment Letter Regarding Draft Report and Draft Report Addendum 19, (June 30, 2008), available at http://comments.treas.gov/_files/PwCCommentLtrTreasCmtDraftandAddendum63008.pdf (supporting this Recommendation). Note that the Committee received testimony and comment letters suggesting that the Department of Labor independence rules be included in this compilation. See, e.g. Deloitte LLP, Comment Letter Regarding Draft Report and Draft Report Addendum 30, (June 27, 2008), available at http://comments.treas.gov/_files/DeloitteLLPCommentLetter.pdf; Record of Proceedings (June 3, 2008) (Written Submission of Kenneth Nielsen Goldmann, Capital Markets and SEC Practice Director, J.H. Cohn LLP, 7), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Goldmann060308.pdf> (recommending the inclusion of the Department of Labor and others in the Recommendation); Mayer Hoffman McCann P.C., Comment Letter Regarding Draft Report and Draft Report Addendum 5, (June 17, 2008), available at http://comments.treas.gov/_files/MayerHoffmanMcCannCommentLetter.pdf (suggesting the Recommendation include the SEC, PCAOB, AICPA, DOL, and GAO).

²⁶⁷ The Committee took note of concerns expressed regarding independence issues from a variety of perspectives. See, e.g., Andrew D. Bailey, Jr., Professor of Accountancy—Emeritus, University of Illinois, and Senior Policy Advisor, Grant Thornton LLP, Comment Letter Regarding Discussion Outline 9 (Jan. 30, 2008), available at http://comments.treas.gov/_files/BAILEYCOMMENTSONTREASURYADVISORYCOMMITTEEOUTLINEFINALSUBMISSION13008.doc (suggesting simplifying the current SEC independence standards); Dana R. Hermanson, Kennesaw State University, Comment Letter Regarding Discussion Outline 1 (Oct. 4, 2007), available at <http://>

(b) Develop training materials to help foster and maintain the application of healthy professional skepticism with respect to issues of independence and other conflicts among public company auditors, and inspect auditing firms, through the PCAOB inspection process, for independence training of partners and mid-career professionals.

The Committee considered testimony and commentary that, to comply with the detailed and complex²⁶⁸ requirements, some auditors may be taking a “check the box” approach to compliance with independence requirements, and losing focus on the critical need to exercise independent judgment or professional skepticism about whether the substance of a potential conflict of interest may compromise integrity or objectivity, or create an appearance of doing so.²⁶⁹

The Committee recommends that auditing firms develop appropriate independence training materials for auditing firms, especially partners and mid-career professionals, that help to foster a healthy professional skepticism with respect to issues of independence that is objectively focused and extends beyond a “check the box” mentality.²⁷⁰

comments.treas.gov/_files/HermansonStatement10407.pdf (stating that consulting and auditing were incompatible and posed a significant threat to the long-term sustainability of the profession); Record of Proceedings (Dec. 3, 2007) (Written Submission of Dennis M. Nally, Chairman and Senior Partner, PricewaterhouseCoopers LLP, 5), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Nally120307.pdf> (“The independence rules should be re-evaluated periodically to examine whether the rules continue to strike the right balance between cost burden and benefit.”); Record of Proceedings (Dec. 3, 2007) (Written Submission of James S. Turley, Chairman and Chief Executive Officer, Ernst & Young LLP, 5), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Turley120307.pdf> (recommending consideration of potential changes to aspects of independence rules). Note that one witness called for adoption of a single set of independence rules for public and private companies. See, e.g., Record of Proceedings (June 3, 2008) (Written Submission of Kurt N. Schacht, Managing Director, Centre for Financial Market Integrity, CFA Institute, 6), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Schacht060308.pdf>.

²⁶⁸ See, e.g., Record of Proceedings (Dec. 3, 2007) (Written Submission of Michael P. Cangemi, President and Chief Executive Officer, Financial Executives International), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/12032007/Cangemi120307.pdf>; Financial Executives International, Recommendations to ADDRESS Complexity in Financial Reporting (Mar. 2007).

²⁶⁹ See, e.g., Consideration of Fraud in a Financial Statement, Interim Auditing Standard AU 316, Paragraph.13 (Pub. Company Accounting Oversight Bd. 2002) (“Professional skepticism is an attitude that includes a questioning mind and a critical assessment of audit evidence.”).

²⁷⁰ See, e.g., Record of Proceedings (June 3, 2008) (Written Submission of Dan Guy, Former Vice

The training materials should focus on lessons learned and best practices observed by the PCAOB in its inspection process and the experience of other relevant regulators as appropriate. To ensure the implementation of this training on an overall basis, the PCAOB should review this training as part of its inspection program.

Recommendation 5. Adopt annual shareholder ratification of public company auditors by all public companies.

Although not statutorily required, the majority of public companies in the United States—nearly 95% of S&P 500 and 70%–80% of smaller companies—put auditor ratification to an annual shareholder vote.²⁷¹ Even though ratification of a company’s auditor is non-binding, the Committee learned that corporate governance experts consider this a best practice serving as a “check” on the audit committee.²⁷² Pursuant to Sarbanes-Oxley, audit committees of exchange-listed companies must appoint, compensate, and oversee the auditor.²⁷³ SEC rules implementing Sarbanes-Oxley specifically permit shareholder ratification of auditor selection.²⁷⁴ Ratification allows shareholders to voice a view on the audit committee’s work, including the reasonableness of audit fees and apparent conflicts of interest.

The Committee believes shareholder ratification of auditor selection through the annual meeting and proxy process can enhance the audit committee’s

President, Professional Standards and Services, American Institute of Certified Public Accountants, 3), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Guy060308.pdf> (stating that auditors fail to detect material financial statement fraud due to, among other things, the lack of professional skepticism); Record of Proceedings (June 3, 2008) (Written Submission of Brian O’Malley, Senior Vice President and General Auditor, Nasdaq Stock Market, 3), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/OMalley060308.pdf> (noting that “auditor skepticism throughout an auditor’s career is the keystone, all incentives and disincentives should be focused on its achievement”); PricewaterhouseCoopers, Comment Letter Regarding Draft Report and Draft Report Addendum 19, (June 30, 2008), available at http://comments.treas.gov/_files/PwCCommentLtrTreasCmtDraftandAddendum63008.pdf (stating that “independence forms the bedrock of credibility in the auditing profession, and is essential to the firm’s primary function in the capital markets”).

²⁷¹ Institutional Shareholder Services, ISS U.S. Corporate Governance Policy—2007 Update 3 (Nov. 15, 2006).

²⁷² Institutional Shareholder Services, Request for Comment—Ratification of Auditors ON THE Ballot 1.

²⁷³ Sarbanes-Oxley Act, 15 U.S.C. § 78j–1 (2002).

²⁷⁴ SEC, Final Rule: Standards Related to Listed Audit Committees. Release No. 33–8220 (Apr. 9, 2003).

oversight to ensure that the auditor is suitable for the company’s size and financial reporting needs.²⁷⁵ This may enhance competition in the audit industry. Accordingly, the Committee encourages such an approach as a best practice for all public companies. The Committee also urges exchange self-regulatory organizations to adopt such a requirement as a listing standard. In addition, to further enhance audit committee oversight and auditor accountability, the Committee recommends that disclosure in the company proxy statement regarding shareholder ratification include the name(s) of the senior auditing partner(s) staffed on the engagement.²⁷⁶ The

²⁷⁵ See also FRC Update 5, 7 (recommending that “the FRC should amend the section of the Smith Guidance dealing with communications with shareholders to include a requirement for the provision of information relevant to the auditor re-selection decision,” and that “investor groups, corporate representatives, firms and the FRC should promote good practices for shareholder engagement on auditor appointment and re-appointments”).

²⁷⁶ See, e.g., Andrew D. Bailey, Jr., Professor of Accountancy—Emeritus, University of Illinois, and Senior Policy Advisor, Grant Thornton LLP, Comment Letter Regarding Draft Report and Draft Report Addendum 4, (June 16, 2008), available at http://comments.treas.gov/_files/TREASURYLETTER3BAILEY61608.doc (“Knowing that any failure will be clearly and unambiguously associated with the named individuals and that the veil of the firm will not be there to obscure their responsibility may be of value.”); Record of Proceedings (June 3, 2008) (Written Submission of Jean C. Bedard, Timothy B. Harbert Professor of Accounting, Department of Accountancy, Bentley College, 11), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Bedard060308.pdf> (supporting the Recommendation and suggesting further that the Committee recommend an advisory shareholder vote on each member of the audit committee for companies that have not adopted a majority vote provision for all board members, and that the engagement partner sign both his or her name as well as the firm’s name to the audit report, making it a more direct public statement of responsibility than proxy disclosure); Paul Lee, Director, Hermes Equity Ownership Services Limited, Comment Letter Regarding Draft Report and Draft Report Addendum 4, (June 13, 2008), available at http://comments.treas.gov/_files/ACAPresponse13Jun08.pdf (stating that an auditor should not continue in office unless it receives a majority of the votes of shareholders in favor of ratification, and noting that accountability and professional judgment would be increased if auditors’ reports were signed by individuals as well as in the names of the relevant audit firm); Record of Proceedings (June 3, 2008) (Written Submission of Kurt N. Schacht, Managing Director, Centre for Financial Market Integrity, CFA Institute, 6), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Schacht060308.pdf> (supporting the Recommendation and further recommending disclosure of other key engagement individuals in addition to the lead audit partner, and transparent disclosure of audit quality, firm financial strength, and professional skill level at least to the audit committee, if not publicly). But c.f., Deloitte LLP, Comment Letter Regarding Draft Report and Draft Report Addendum 21–22, (June 27, 2008), available at http://comments.treas.gov/_files/

Continued

Committee notes that there might be other audit-engagement specific data, such as the auditor's tenure with a specific public company client, useful to shareholders and audit committees.

Recommendation 6. Enhance regulatory collaboration and coordination between the PCAOB and its foreign counterparts, consistent with the PCAOB mission of promoting quality audits of public companies in the United States.

The globalization of the capital markets has compelled regulatory coordination and collaboration across jurisdictions. Regulators of public company auditors are no exception, as companies increasingly seek investor capital outside their home jurisdictions and the larger auditing firms create, expand, and, in some audits, increasingly rely on global networks of affiliates in order to provide auditing and other services to companies operating in multiple jurisdictions.²⁷⁷ The Committee considered commentary

DeloitteLLPCommentLetter.pdf (noting that the Recommendation goes against the team nature of audits, raises personal security and privacy concerns, and is unrelated to audit quality); Ernst & Young LLP Comment Letter Regarding Draft Report and Draft Report Addendum 28, (June 27, 2008), available at <http://comments.treas.gov/lowbar/files/EYACAPCommentLetterFINAL.pdf>; Mayer Hoffman McCann P.C., Comment Letter Regarding Draft Report and Draft Report Addendum 3, (June 17, 2008), available at <http://comments.treas.gov/files/MayerHoffmanMcCannCommentLetter.pdf> (suggesting that "[o]ther individuals involved in the audit might actually feel less responsibility if only the engagement and concurring partners sign the report or only top partners are named, precisely the opposite of what should be encouraged"); David McDonnell, Chief Executive Officer, Grant Thornton International Ltd, and Edward E. Nusbaum, Chief Executive Officer, Grant Thornton LLP, and Chairman, Grant Thornton International Ltd Board of Governors, Comment Letter Regarding Draft Report and Draft Report Addendum 4, (June 27, 2008), available at http://comments.treas.gov/files/GTCommentLettertoACAPJune2008_FINAL.pdf (noting the team effort aspect of audits and stating that partners may be unwilling to accept the added risk, personal security issues, and privacy issues). As discussed above, the Committee also believes that this ratification process would be made more meaningful if accompanied by the development and disclosure of key indicators of audit quality.

²⁷⁷ See Record of Proceedings (Feb. 4, 2008) (Written Submission of Cynthia M. Fornelli, Executive Director, Center for Audit Quality, 16), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/02042008/Fornelli020408.pdf> (noting the "growing consensus that regulators on every continent would be well served by working more closely together in the interest of improving worldwide audit quality"); PCAOB Press Release, PCAOB Meets with Asian Counterparts to Discuss Cooperation on Auditor Oversight (Mar. 23, 2007), available at http://www.pcaobus.org/News_and_Events/News/2007/03-23.aspx ("The PCAOB strongly believes that dialogue and cooperation among auditor regulators are critical to every regulator's ability to meet the challenges that come with the increasingly complicated and global capital markets.").

regarding the PCAOB's regulatory role on a global basis.²⁷⁸

The PCAOB has the statutory responsibility for ensuring quality audits of public companies. In a world of global business operations and globalized capital markets, the PCAOB benefits from cooperation with foreign auditing firm regulators (many created and modeled after the PCAOB) to accomplish its inspections of registered foreign auditing firms, including firms that are members of global auditing firm networks.

In May 2007, the PCAOB hosted its first International Auditor Regulatory Institute where representatives from more than 40 jurisdictions gathered to learn more about PCAOB operations. In 2006, the PCAOB formally joined the International Forum of Independent Audit Regulators, created to encourage regulatory collaboration and sharing of regulatory knowledge and experience.

The Committee believes that these types of global regulatory coordination and cooperation are important elements in making sure public company auditing firms of all sizes are contributing effectively to audit quality. The Committee strongly supports the efforts of the PCAOB to enhance the efficiency and effectiveness of its programs by communicating with foreign regulators and participating in global regulatory bodies. The Committee urges the PCAOB and its foreign counterparts to continue to improve regulatory cooperation and coordination on a global basis.²⁷⁹

²⁷⁸ See, e.g., PCAOB Briefing Paper, Oversight of Non-U.S. Public Accounting Firms (Oct. 28, 2003); PCAOB Final Rules Relating to the Oversight of Non-U.S. Public Accounting Firms, PCAOB Rel. No. 2004-005 (June 9, 2004); Request for Public Comment on Proposed Policy Statement: Guidance Regarding Implementation of PCAOB Rule 4012, PCAOB Rel. No. 2007-001 (Dec. 5, 2007); PCAOB Chairman Mark Olson and EU Commissioner Charlie McCreevy Meet to Discuss Furthering Cooperation in the Oversight of Audit Firms, PCAOB Press Rel. (March 6, 2007); PCAOB Meets with Asian Counterparts to Discuss Cooperation on Auditor Oversight, PCAOB Press Rel. (Mar. 23, 2007); Establishment of the International Forum of Independent Audit Regulators, Haut Conseil du Commissariat aux Comptes Press Rel. (Sep. 15, 2006); PCAOB Enters into Cooperative Arrangement with the Australian Securities and Investments Commission, PCAOB Press Rel. (July 16, 2007); Board Establishes Standing Advisory Group, PCAOB Press Rel. (Apr. 15, 2004).

²⁷⁹ See, e.g., Joseph Carcello, Chair, AAA Task Force to Monitor the Activities of the Treasury ACAP Ernst & Young Professor and Director of Research—Corporate Governance Center University of Tennessee, Jean C. Bedard Timothy B. Harbert Professor of Accountancy Bentley College, Dana R. Hermanson Dinos Eminent Scholar Chair of Private Enterprise and Professor of Accounting Kennesaw State University, Comment Letter Regarding Draft Report and Draft Report Addendum 11, (May 15, 2008), available at <http://comments.treas.gov/files/ACAPCommentLetterMay152008.pdf> (agreeing with

In addition, the Committee recognizes the challenges that the globalized regulatory environment creates for smaller firms, particularly with respect to the increasing acceptance of IFRS.²⁸⁰ The Committee believes that regulators and policy makers must recognize the importance of including smaller firms in international roundtables, discussions, and policy making decisions.²⁸¹

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BILLING CODE 4810-25-P

DEPARTMENT OF THE TREASURY

Fiscal Service

Surety Companies Acceptable on Federal Bonds: Axis Insurance Company

AGENCY: Financial Management Service, Fiscal Service, Department of the Treasury.

ACTION: Notice.

SUMMARY: This is Supplement No. 1 to the Treasury Department Circular 570, 2008 Revision, published July 1, 2008, at 73 FR 37644.

FOR FURTHER INFORMATION CONTACT: Surety Bond Branch at (202) 874-6850.

SUPPLEMENTARY INFORMATION: A Certificate of Authority as an acceptable surety on Federal bonds is hereby issued under 31 U.S.C. 9305 to the following company:

the Recommendation); Record of Proceedings (June 3, 2008) (Written Submission of Brian O'Malley, Senior Vice President and General Auditor, Nasdaq Stock Market, 4), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/OMalley060308.pdf> (agreeing with the Recommendation); Record of Proceedings (June 3, 2008) (Written Submission of Kurt N. Schacht, Managing Director, Centre for Financial Market Integrity, CFA Institute, 6), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Schacht060308.pdf> (agreeing with this "most important" Recommendation).

²⁸⁰ Record of Proceedings (June 3, 2008) (Questions for the Record of Mr. Kenneth Nielsen Goldmann, Capital Markets and SEC Practice Director, J.H. Cohn LLP, 21-22 (June 30, 2008)), available at <http://www.treas.gov/offices/domestic-finance/acap/agendas/QFRs-6-3-08.pdf> (noting the difficulty and costs associated with implementing IFRS for smaller firms); Record of Proceedings (June 3, 2008) (Questions for the Record of Mr. Kurt N. Schacht, Managing Director, Centre for Financial Market Integrity, CFA Institute, 73-74 (June 30, 2008)), available at <http://www.treas.gov/offices/domestic-finance/acap/agendas/QFRs-6-3-08.pdf> (stating the difficulty in maintaining competence in IFRS, GAAP, and local/national standards).

²⁸¹ See, e.g., Record of Proceedings (June 3, 2008) (Written Submission of Kurt N. Schacht, Managing Director, Centre for Financial Market Integrity, CFA Institute, 3), available at <http://www.treas.gov/offices/domestic-finance/acap/submissions/06032008/Schacht060308.pdf> (stating that demonstrating technical competence in international matters is of increased importance especially for smaller firms).