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

February 29<sup>th</sup> 2008.

Attention: Kristen Jaconi

Dear Ms. Jaconi:

In my testimony before the Committee on December 3, 2007, I discussed the availability of commercial insurance and whether additional insurance could address the threat of very large judgments that audit firms face. My conclusion is that the insurance markets cannot provide a solution to the threat to audit firm viability posed by these huge claims.

The profession has brought to my attention an approach that might ameliorate this threat somewhat in the short term while a more comprehensive solution is considered.

In recognition of the systemic threats posed to some sectors by litigation, a number of responses have been developed to assist in funding the cost of such litigation. The extensive captive movement and the federal Risk Retention Act are prime examples. However these approaches, while extensively used by both corporate and professional target groups, are not very responsive to the needs of the large auditing firms. This is principally because of two factors. Firstly the concentration of firms makes industry mutuals<sup>1</sup> less practical. Secondly the nature of the audit firm liabilities, with their extreme size and lack of predictability, make the funding of these exposures on a pre tax basis impossible under current vehicles.

The goal would be to enable an audit firm to build a fund that would increase their ability to withstand a huge verdict, a threat that – as I explained in my testimony – is a very real one. However to be economically effective such a fund would need to be structured on a basis that allowed contributions to the fund to be tax deductible and for the fund itself to be protected from tax.

There are already two structures in place that facilitate this approach, but in both cases some changes would need to be made to make them effective for a US audit firm.

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<sup>1</sup> Such as ALAS for major law firms.

The use of captive insurance companies is well established in the US. One approach would therefore be to permit a U.S. audit firm to form its own captive insurance company, which could insure that firm's catastrophic liability risk. Today, however, there are obstacles to this result—for example, premium payments to a captive are tax deductible as “insurance premiums” in the U.S. only if the captive satisfies the rules regarding “unrelated risk”. That rule would have to be amended to allow captives to be used in this manner. Further, the ability to claim a deduction for certain insurance reserves would need to be relaxed to prevent taxation at the insurance company level.

An alternative possible approach builds upon an existing provision of the tax code, Section 461(f), which permits a taxpayer to take a deduction if it “contests an asserted liability” and “transfers money or other property to provide for the satisfaction of the asserted liability,” provided that “the contest with respect to the asserted liability exists after the time of the transfer” and “but for the fact that the asserted liability is contested, a deduction would be allowed for the taxable year of the transfer” after taking into account the economic performance rules of Section 461(h).

My understanding is that this provision today has very limited utility for a number of reasons, including that current interpretations require that the assets be transferred to the claimant, or at least that the claimant be notified of the transfer. Notifying plaintiffs, whose claims are vigorously denied, of the amount of a fund put aside specifically to pay their claim would obviously be a very negative dynamic in the management of claims.

If Section 461(f) were modified to permit audit firms registered with the PCAOB to satisfy the provision's requirements by transferring beyond the control of the audit firm – such as to a trust or similar vehicle – money or other property, from which a potential liability, existing or anticipated, may be satisfied, this device could be used by audit firms to accumulate funds that would provide some additional protection against a “lightening strike” mega-verdict in one or more future cases (the amendment could allow a single fund to be used to satisfy one or more asserted or anticipated liabilities). The same approach might be made available for other similar purposes, such as to allow an audit firm to finance the bond that might be necessary to enable the firm to obtain review by an appellate court of a large adverse verdict.

The revenue impact, which is one of timing, of such an amendment would be limited if it applied only to PCAOB-registered firms, a limitation that would be justified as a policy matter given the greater exposure of audit firms to this sort of risk.

Either of these approaches has the problem I identified in my testimony of increasing the ability to pay rather than controlling to quantum of liability. However, they do appear to provide meaningful methods of enhancing the viability of audit firms in the short term.

Please circulate this letter to the members of the Committee. I would be happy to answer any of the Committee's questions.

Sincerely,

Peter Christie

# NASBA

National Association of State Boards of Accountancy

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February 6, 2008

To: Arthur Levitt, Jr. (Co-Chair)  
Donald T. Nicolaisen (Co-Chair)  
Members of the Advisory Committee on the Auditing Profession

From: David A. Costello, CPA  
President and CEO of NASBA

Re: NASBA Accountancy Licensing Database (ALD)

Recently, NASBA received a list of questions posed by members of the Advisory Committee on the Auditing Profession. The responses are as follows.

Bill Travis has asked:

- 1. What can NASBA do to cause better alignment of rules and requirements (e.g. independence, CPE, etc.) across states and other regulators (to eliminate redundancies and confusion)?**

NASBA has been successful in assisting to better align the rules and regulations across states through the collaborative development of the Uniform Accountancy Act (UAA) and the vigorous methods by which NASBA promotes this model legislation. The most prominent issue facing regulators and the profession is interstate commerce, commonly referred to as mobility. 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.

Recognizing a need for guidance, NASBA and the AICPA developed model language which affectively addresses the issues surrounding mobility. The proposed act allows for state boards to grant practice privileges to CPAs who will be offering services in their state as long as the licensee has met and agreed to certain requirements. While the proposed act does not require any form of registration, agreement to the requirements is implied when the licensee offers services in a state, other than their home state, that has adopted the model language. The requirements include 150 hours of education, a minimum of one year of accounting or auditing experience, and successful completion of the CPA examination. NASBA's website contains a

list of all states who have adopted the aforementioned UAA requirements for licensure. This list allows licensees to easily determine if their state is substantially equivalent to the state in which they plan to offer professional services.

As states adopt the model language, the differences that remain will cease to act as barriers to mobility. For example, many states have enacted a rule which indicates that if a CPA has obtained the CPE necessary to practice in their home state, they would automatically comply with the CPE requirements of the state in which they plan to offer professional services. The concept of independence has more widespread consistency due to the guidance outlined in the AICPA Code of Professional Conduct, a resource which has been adopted by reference by many states. States which have not adopted the Code by reference have included a comprehensive amount of the body of the text within their rules and regulations. Typically, independence standards do not vary from state to state.

NASBA recognizes the benefit of state boards working with other regulators to further improve the system of regulation. Once the perceived redundancies and areas of confusion are clearly identified, NASBA is poised to assist in developing the appropriate tools. With a staff of more than 200 and a volunteer network consisting of hundreds of business professionals, NASBA possesses the expertise and talent needed to provide effective solutions.

Gary Previts has asked:

**2. In order to avoid the implication or suggestion that this panel is simply acting on the basis of foregone conclusions of its members, it is very important that we obtain the types of data, especially demographic, which we would ask of any responsible professional body. Since the 1970s your organization has been proposing and making modest progress toward a National Registry of CPAs, i.e. perhaps something that could be portrayed as a type of CPA Census. However I found the number of individual registrants you cited in your testimony (658,000) as being unacceptably high. I am speaking from my knowledge of the history of accounting and data sources such as AICPA membership, etc. The fault I find in the number you gave in your testimony is that it includes multiple registrants. For example I am a CPA currently registered in both the State of Ohio and in the State of Alabama, so I am counted twice, and so forth.**

**(a) Would you please comment on the history of developing your registry, which from your recent NASBA 100 year history suggests this project has been underway for over 30 years? And also would you comment on the importance of such data in order to properly evaluate and assist in recruitment and retention of the best and the brightest individuals? Do you agree that such data are vital to the successful understanding and advancement of the CPA Profession generally?**

Since 1970, the National Association of State Boards of Accountancy (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. "The registry was to include full information

about individual CPAs, including CPE records and disciplinary actions taken.” [100 Years of NASBA - Serving the Public Interest, Dale L. Flesher, 2007] Although the need for a national registry of CPAs has been recognized for 30 years, actual work on developing the registry only began in earnest about five years ago. NASBA recognized the critical need for a national accountancy licensee database (ALD) and began to encourage our member boards to participate in the development and current maintenance of such database. Technology now makes such a database much more practical and applicable to boards, the profession, and the public than would have been possible when the registry was first talked about.

In 2003, a task force was convened to assist with the design of the registry and promote the participation of all 55 jurisdictions. As NASBA’s technology experts developed the foundation, the task force identified information that would be critical to the success of the ALD. In 2005, the US Accountancy Licensee Database (ALD) was introduced and only two years later contains submissions from 13 states. The success of the ALD is in line with the projections set forth in the Business Plan that was established in 2003 and will continue to grow as NASBA contributes the resources necessary to obtain consistent submission from 55 jurisdictions. No other organization has the necessary relationship with the state boards of accountancy to implement this project.

The objectives of the US Accountancy Licensee Database, as identified in the Business Plan, are as follows:

- Provide state and federal regulators with better tools to identify licensees who practice within their jurisdictions.
- Reduce the time and cost associated with submitting a notification to practice and increase assurances for boards that out-of-state licensees are complying with all practice requirements thereby removing barriers to interstate practice.
- Provide licensees with quicker turnaround times when requesting notifications to practice under substantial equivalency.
- Make regulation more efficient and effective by facilitating communications among boards.
- Enable boards to streamline many of their processes, including verification of other states’ licensees and any correlated disciplinary actions.
- Provide another avenue for uniformity among boards.
- Create a mechanism for the PCAOB and other users to efficiently verify firm registration information.
- Provide a resource to the public for finding qualified licensees.
- Assist accounting firms in verifying pre-hire credentials, monitor the renewal activities of their active employees and satisfy various licensure requirements.

**3. Will you please provide our subcommittee with the following data from your Registry:**

- a. **How many 'single counted' individuals are there in the fifty five jurisdictions who hold an 'active' CPA registration or license?** Each state board maintains a database which includes the individuals that have been licensed in their states. A portion of this database is imported into the ALD to populate the designated fields. Currently, NASBA is not aware of a mechanism or database which would provide an accurate count of CPAs, without the effect of "double counting." For this reason, NASBA is eager to expedite the submission of states into the ALD and has committed resources to ensure the inclusion of all states within the near future. Once all states are part of the ALD, the system can identify records that have been counted more than once and those can be eliminated from the total count. Based on license status groupings that are provided, the ALD reflects 176,000 CPAs in 14 states. Please see the attached table for more information regarding CPA statistics.
  - b. **How many of the above are inactive CPAs?** Based on license status groupings that are provided, the ALD reflects 14,544 inactive CPAs.
  - c. **How many of the above participate/are involved in public company audits?** This information is not typically captured by the state boards. Therefore, it is not included in the ALD. The information is valuable and could be added to the database once states have added it to their records.
  - d. **How many are men, and how many are women?** The ALD reflects a population of 71,107 males, 43,825 females, and 45,883 who are non-responsive. The ALD does not capture data pertaining to the number of men and the number of women who are involved in public company audits.
  - e. **What is the average age of this population?** The average age of the licensee in the ALD is 49. The ALD does not capture data pertaining to the average age of those who are involved in public company audits.
  - f. **How many of these individuals have a graduate degree level of education?** Of the information that was provided, 5,855 have received a graduate degree. Please see the attached table for more information.
- 4. If NASBA cannot provide this information at this point in time, when will NASBA be able to do so?** NASBA will continue to add states to the ALD and will continue to increase the robustness of this database. Comparable and complementary to its work on Mobility, NASBA is "surging" its efforts to fast track conversion of states to the ALD. As noted in the objectives, the system was designed primarily to provide assistance to state boards. Once a majority of states are included on the ALD, it can be opened to outside sources to assist with various regulatory and recruitment efforts.
- 5. If NASBA cannot provide this information, who can?** See responses below.

- a. **What is the mean age of a person obtaining a master's degree in accounting?** Since most states require 150 hours of education for licensure, information pertaining to graduate degrees is secondary. As a result, it is not consistently provided in board records. Additionally, for states that capture graduate degree information, they may not capture the specific concentration related to the degree.
- b. **What is the mean age of all CPA certificate holders?** The average age of the licensee in the ALD is 49.
- c. **What is the mean age of a person when the original CPA certificate is first awarded (exclude subsequent reciprocal certificates awarded)?** The mean age of a person at initial licensure is 31.
- d. **How many accounting graduates are hired each year for public company audit service?** This information is, typically, not maintained in the state board databases and, accordingly, is not currently included in the ALD.
- e. **How many accounting graduates holding accounting graduate degrees are hired by the largest four auditing firms?** This information is, typically, not maintained in the state board databases and, accordingly, is not currently included in the ALD. Communication with the administrative offices of each of the Big 4 may provide the requested information.

ALD Licensee Statistics

Total on Database		176,165
Number of Active CPAs		134,777
Number of Inactive CPAs		14,544
Disciplined		1,194
Gender:		
Male		71,107
Female		43,825
no response		45,883
How many have a graduate degree?	1	5,855
Mean Age of licensee		49
Mean Age at initial licensure		31

1 The requirement to sit for the CPA exam, in accordance with the UAA, is 150 hours of education. As a result, files do not necessarily contain graduate degree information; only information which supports the 150 hours. For this particular statistic, only 13,000 responses were obtained.

States loaded into ALD (13)	
Alaska	Oklahoma
Arkansas	Puerto Rico
Idaho	Tennessee
Louisiana	Texas
Missouri	West Virginia
New Mexico	Wyoming
Nevada	





**James Cox, Brainerd Currie Professor of Law, School of Law, Duke University**  
**Advisory Committee on the Auditing Profession**  
**Questions for the Record**  
**December 3, 2007**

Committee member Gary Previts has asked:

The *Continental Vending* case, which was instigated by events in the mid 1960s and litigated through a Supreme Court decision, seemed to say that 'principles' based GAAP was an insufficient defense. As a consequence, the United States abandoned the principles approach (i.e. The Accounting *Principles* Board) for a standards/rules approach, thus the Financial Accounting *Standards* Board. Why should we expect the principles-based approach to be successful today when it was not successful in the 1960s and 1970s? The precedent seems to be *Continental Vending*. A historical skepticism seems to suggest that we are going in circles, unless there is clear and direct evidence in court decisions since *Continental Vending*. What has changed?

In *United States v. Simon*, 425 F.2d 796 (2d Cir. 1969), cert. denied, 397 U.S. 1006(1970), the Second Circuit, through Judge Friendly (one of his later clerks was John Roberts, now Chief Justice), affirmed the denial of an instruction to the jury that would permit the jury in a criminal case to convict an accountant only if he willfully disregarded an accounting (or auditing) standard, notwithstanding that the presentation of the audit client's financial position was found not to be fairly presented. This is a lot of double negatives, but *Simon* is roundly, and I believe quite correctly, cited for the proposition that bare compliance with an accounting principle or auditing standard is not a defense if the accountant knows this does not fairly present the audited firm's financial position or performance. This comes from the Judge Friendly's statement "Proof of compliance with generally accepted standards was "evidence" which may be very persuasive but not necessarily conclusive that he acted in good faith, and that the facts as certified were not materially false or misleading." In the next paragraph, there appears so wiggle room where Friendly justifies this result "at least . . . when the accountant's testimony was not based on specific rules." In the case, the question was whether post closing information about the loan collateral as well as knowledge that the loan was actually owed indirectly by the controlling stockholder of the lender. Representatives of the seven other big accounting firms all testified that GAAS and GAAP did not require this disclosure. Thus, it would seem to me that *U.S. v. Simon* undercuts in substantial ways the argument that auditors need principles because precisely articulated standards will be a defense. But for Friendly's "at least" qualification quoted above, the case clearly appears to make everything turn on judgment and knowledge of probable effect. It also seems to me that Friendly overall statement is that judgment and knowledge are critical and the ultimate question is fair presentation and even if there were a principle the accountant could point toward that would still invite a jury question whether under the facts the accountant cannot hide behind a "rule" when the facts and circumstances suggest his/her judgment

was that this did not fairly present the audit client's position or performance. All this said, there are some reasons to suspect that a principles approach will protect the auditor who acts reasonably under the circumstances. First, the auditors today enjoy a heightened pleading requirement under the PSLRA that they did not enjoy before. This does reduce the likelihood of the plaintiff's complaint surviving a motion to dismiss. Second, stronger audit committees and internal controls suggest that if there is fraud it was very well concealed and thus less likely to have been known to the accountant (absent specific allegations that satisfy the pleading standard). At the same time, it does seem to me that absent a "rule" to hide behind that the accountant may be vulnerable by asserting only a judgment. That is what while I stated in my testimony I was "intrigued" by caps on accountants' liability, my preference would be a rule or statutory safe harbor that covered the accountant who made a good faith judgment that the presentation fairly reported the transaction. This seems to be exactly what Henry Friendly said was in order particularly when there was no rule on the subject. I hope this is helpful in thinking through this very tough and important question.

**LAWRENCE A. CUNNINGHAM**  
GEORGE WASHINGTON UNIVERSITY LAW SCHOOL  
2000 H STREET, NW  
WASHINGTON, DC 20052

January 30, 2008

Ms. Kristen E. Jaconi  
Senior Policy Advisor to the  
Under Secretary for Domestic Finance  
Department of the Treasury  
1500 Pennsylvania Avenue, NW  
Washington, DC 20220

*Advisory Committee on the Auditing Profession:  
Response to Question for the Public Record*

Dear Ms. Jaconi:

You asked me to respond for the public record to the following question, posed by Bill Travis, a Member of the Advisory Committee on the Auditing Profession, arising out of views I offered at that Committee's December 3, 2007 public meeting: "*Since more insurance isn't a good solution, can adequate amounts of deterrence be addressed through tough SEC/PCAOB sanctions to individuals and firms along with reasonable liability caps and [from] changes in more transparency, enhancements in governance and PCAOB reporting on firm quality assurance systems?*" Please accept the following as my response.

I am uncertain about the question's premise, "Since more insurance isn't a good solution." It is unclear from the question what problem to which insurance is not "a good solution." If the problem is the risk of catastrophic liability that destroys an auditing firm, it seems premature to state this premise as a conclusion. At the public meeting and in published writings, I proposed that audit firms obtain additional insurance-like resources by issuing capital market bonds to neutralize the risk that catastrophic liability judgments arising from audit failure destroys a firm.

I am not aware that any firm has explored this alternative to justify eliminating it from the public discussion. If the Advisory Committee has information demonstrating that the firms have exhausted this alternative with capital market participants, that would lend weight to the premise that "insurance isn't a good solution" to this risk. It would not be conclusive, of course, unless the information were made public so that lawmakers and their constituents could evaluate whether such insurance is or is not a good solution to the risk of firm destruction from catastrophic liability due to audit failure

Alternatively, the question suggests that the problem to be solved is assuring optimal deterrence. Insurance may be a poor solution to this problem, given the risk of moral hazard and other costs of shifting liability to third parties. But it seems difficult to avoid recognizing the likely need for firms to obtain some external resources to withstand the risks inherent in any professional services practice, as well as the catastrophic risks of audit failure.

Ms. Kristen E. Jaconi  
January 29, 2008  
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The issue that the question seems to be probing is what elements of system design can be useful to promote deterrence so that auditors comply with requirements and overcome incentives to depart from them. Many components of a system influence its deterrence level. Among those mentioned in the question, liability caps certainly reduce deterrence, SEC and PCAOB sanctions certainly increase it and the others (more transparency, governance enhancements and PCAOB reporting on firm quality assurance systems) have an uncertain and non-obvious effect (in part because more detailed specification of these ideas would be required).

Ultimately the question, then, seems to ask whether the existing system can be redesigned to assure that tough public sanctions offset weaker private remedies. In theory, this should be possible. So long as the amount at risk (in public sanctions or private remedies) times the probability of enforcement results in optimal deterrence, it does not matter whether the apparatus is activated by public regulation or private litigation. The fighting issue arises from competing concerns: (a) optimal public sanction amounts may not be accompanied by optimal public enforcement intensity versus (b) optimal private enforcement intensity may be accompanied by supra-optimal damages amounts.

On one hand, evaluating the competing concerns requires considering the probability of achieving optimal public enforcement intensity. The SEC's propensity to pursue such enforcement varies over time. The SEC's priorities change in response to market developments and budgetary constraints. PCAOB has been in operation for only five years and its continued existence cannot be assumed; it has been forced to juggle responsibilities that distract from enforcement. It may be unwise to count on either to provide requisite enforcement intensity.

On the other hand, the risk of supra-optimal damages amounts, especially the acute concern that these may induce firm destruction, can be handled by means other than ex ante caps. Insurance, in the form of firms issuing capital market bonds, may well be a solution. If that solution were in fact not good, the issue becomes more political than empirical or theoretical, a gamble between over or under deterrence.

Sincerely yours,  
*L. A. Cunningham*  
Lawrence A. Cunningham  
Professor of Law

**M E M O R A N D U M**

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February 19, 2008

TO: The Department of the Treasury's Advisory Committee on the Auditing Profession

FROM: James R. Doty

RE: Implications of Liability, Litigation and Governance Structure -- Response to Questions by Committee Member William Travis

I. Question Presented:

Since more insurance isn't a good solution, can adequate amounts of deterrence be addressed through tough SEC/PCAOB sanctions to individuals and firms along with reasonable liability caps, firm changes in the direction of more transparency, enhancements in governance, and through PCAOB reporting on firm quality assurance systems?

II. The Fallacy Of The Tort Regime: The Confusion Of Class Action Litigation And Deterrence

The fallacy committed by advocates of continuing private, civil tort litigation in this arena lies in their confusion of the threat of the uninsurable "mega claims" with deterrence. The current litigation regime involves two quite difficult elements: (i) tort recovery by private litigations, and (ii) government sanctions by the SEC and PCAOB. The first of these elements, tort litigation, threatens the continued existence of the independent audit profession, inflicting the twin risks of "death by a thousand cuts" or extinction by the "mega-claim." That threat is the inevitable result of the interest of tort litigants in maximizing the award, without regard to the impact on audit-firm quality or professional viability. The second element, regulatory sanction, has only one purpose – deterrence of audit failure and enhancement of audit quality.

When that fallacy is identified, the response to this most valid question becomes clearer: the administrative law regime is the best and only means we have of achieving meaningful deterrence and enhanced audit capability.

Permit us to expand on my prior written submission and attempt to explain why.

### III. Why The Administrative Regime Can Achieve Deterrence Of Audit Failures And Enhancement Of Quality

No doubts should linger about the capabilities (or willingness) of the SEC and PCAOB to regulate firms and identify the cases which merit sanctions. Neither is “under funded” and both have the requisite institutional expertise. The SEC budget now approaches \$1 billion. The PCAOB has now just over four years of operation under its belt, has established its own enforcement group, has brought one case against a major firm and is believed to be preparing cases against others. The community of registrants – reporting companies issuing audited financial statements – has been vocal about the increased stringency of the audits and the independence of the firms’ national offices in the application of accounting principles. All of this renewed energy in the execution of the audit has come at a time when the Congress and the Federal courts were imposing heightened pleading standards on Federal securities litigation; but that phenomenon has not diminished audit quality – to the contrary.

What, then, is the causal relationship between this SEC/PCAOB regulatory enforcement pattern and deterrence?

First, the SEC/PCAOB sanctions fall on individuals; and that has a deterrent effect unattainable by the tort awards. An axiom, often cited by auditors to lawyers, states that an internal control system is ultimately only as good as the people implementing the controls. The same may be said of audits. As indicated by my written submission, SEC Rule 102(e) grants career-ending power to the SEC, which can be invoked as a sanction in the appropriate case for a single, negligent act. For audit partners and their supervisors, this threat represents the most potent deterrent.

The PCAOB, by way of supplemental deterrence, creates actual transparency into the audit. Thus, short cuts and neglect in audit quality that may exist, whether in designing the scope of the audit or in its execution, and including missteps below the supervisory level, are subject to being discovered and reported on. Even where such lapses have not resulted in audit failure, there may be adverse professional consequences for staff and supervisors whose oversights are included in a PCAOB report.

Here emerges a fundamental distinction between regulations and private tort litigation. The latter is engaged only when audit failures become public. The former, SEC/PCAOB enforcement, will identify and sanction the persons responsible for an audit failure; but more important, PCAOB quality reviews can actually prevent concealment and repetition of lesser mistakes that can eventually lead to audit failure.

### IV. Other Needed Changes

Litigation reform: If auditing firms could appeal the denial of a motion to dismiss (as they could not in the case of the Parmalat failure of a foreign audit) if appeal bonds were capped at reasonable amounts, the result would weed out meritless claims, asserted merely to compel settlement. That reform would not, of course, forestall the SEC or PCAOB from looking into the facts behind a claim; and in such cases courts should extend Chevron deference to the agencies’ determination that the audit firm did not engage in reckless or fraudulent conduct. In

those cases, quick resolution of the tort litigation would result in efficiency in the legal system as a whole: the PCAOB would be free to impose follow-on quality remediation. Thus, neither deterrence nor transparency would be diminished, and sanctions would nevertheless exist for negligent individuals.

Bankruptcy reform: Permitting both the firm and its partners to invoke the automatic stay under Section 362 of the Code, not only permits rehabilitation of a “distressed firm” – one whose capital is depleted by the “thousand cuts” of smaller cases or threatened by the “mega case” – but also gives the PCAOB needed time to assess the internal reforms and remediation needed to bring the firm’s quality controls up to the mark. In this regard, the audit firm would finally enjoy some of the “stabilizing” institutional options of the unregulated community of corporate issuers.

Governance reform: If audit firms could organize as limited liability companies or more traditional corporate entities, and had access to capital markets in “tracking securities” or subordinate debt issues, their capital could be increased without direct access to their partners. The authority of the PCAOB, as a merit regulator in the model of the Federal Reserve, could provide oversight to assure both prudential solvency and transparency. Thus organized, the major audit firm would resemble more the model of the regulated public utility, in which partners – equity holders – should be assured a reasonable return on invested capital, and in which financial solvency and leverage would be transparent to the regulator.

All of this, of course, takes us away from the “hit-or-miss”, entrepreneurial case management of the tort litigation regime.<sup>1</sup> In basing deterrence on the existing regime of regulatory, civil law enforcement, society might actually avoid another miscalculation of the kind that destroyed Arthur Andersen. The statutory proposals, discussed above, in no way lessen the serious nature of SEC/PCAOB enforcement. Such measures would actually permit the federal regulatory sanctions (including Fair Funds for investors where warranted) to operate without the distraction of tort litigation.

\* \* \* \* \*

An old aphorism regarding business and legal institutions may be instructive:

“If you always do what you’ve always done, you’ll always get what you’ve always got.”

Put slightly differently, Ben Franklin defined insanity as being confronted with a problem, doing exactly the same thing over and over, and expecting different results. The results of injecting private tort litigation into audit failures in the hope of achieving deterrence has resulted in “the Big Eight” dwindling to the “Major Four” – and such firm failures will not produce the enhancements of quality and auditor vigilance. Those benefits require the regulatory changes and proposals discussed above.

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<sup>1</sup> As argued in my original submission, the litigation and bankruptcy reforms would actually add discipline and inhibit private litigants from disastrous miscalculations of likely recovery.



**Lewis H. Ferguson, Partner, Gibson, Dunn & Crutcher**  
**Advisory Committee on the Auditing Profession**  
**Questions for the Record**  
**December 3, 2007**

**In the course of your testimony, you suggested that “federal authorities . . . issue standards as to how auditors should exercise and document their professional judgment . . . and provide some protective coverage for audits that meet those standards so that the auditor’s judgments can withstand second guessing by regulators and litigants.”**

**1. What should those standards be?**

Adoption of any such standard would obviously require careful consideration and detailed review by a number of constituencies, including the relevant regulatory authorities and the profession itself. In my view, the central principle underlying any such standard would be the concept that auditors should be protected when they exercise their judgment in the conduct of an audit or preparation of financial reports in good faith and based on a reasonable application of U.S. Generally Accepted Accounting Principles ("GAAP") (or such other accounting principles acceptable under applicable Securities and Exchange Commission rules), Standards of the Public Company Accounting Oversight Board, or such other attestation standards as may be applicable. The good faith and reasonable application components of the standard would recognize that GAAP in many cases require auditors to exercise judgments and make choices, and that such judgments and choices, when made in good faith and reasonably reflecting GAAP requirements, should be both encouraged and protected. In order to obtain the protection, auditors would have both to exercise that good-faith and reasonable judgment, and also to document, in accordance with applicable professional standards, the underlying facts and circumstances surrounding the decision and the reasoning behind the final decision made.

**2. How could the “protective coverage” concept be built into existing regulatory and justice systems?**

The “protective coverage” concept could be built into the existing regulatory and justice systems through the SEC’s creation of a safe harbor for the professional judgments of auditors. This can be achieved through an SEC regulation that provides protection from both civil liability and SEC enforcement actions where objective criteria are met, and extends to both the professional judgments of independent auditors, and the business judgments of issuers and their officers and directors in their financial reporting oversight role.

The SEC’s authority to create such a safe harbor stems from its broad power to grant exemptions from the provisions of the Securities Act of 1933 (“Securities Act”) and the Securities Exchange Act of 1934 (“Exchange Act”). Section 21E(g) of the Exchange Act provides:

*In addition to the exemptions provided for in this section, the Commission may, by rule or regulation, provide exemptions from or under any provision of this title [15 U.S.C. §§ 78a et seq.],*

including with respect to liability that is based on a statement or that is based on projections or other forward-looking information, if and to the extent that any such exemption is consistent with the public interest and the protection of investors, as determined by the Commission.

Exchange Act § 21E(g), 15 U.S.C. § 78u-5(g) (emphasis added); *see also* Securities Act § 27A(g), 15 U.S.C. § 77z-2(g) (same).

Notably, the Commission's exemptive authority applies to "any provision" of the Acts, and thus covers both the Securities Act and the Exchange Act as amended by the Private Securities Litigation Reform Act—not just selected provisions of those Acts. Congress has therefore given the Commission authority to provide exemptions for any liability arising under the Acts. Moreover, because the exemptive authority extends to "liability" generally, it is not restricted simply to enforcement actions.

The one restriction on the Commission's ability to provide exemptions is that "any such exemption" must be "consistent with the public interest and the protection of investors, as determined by the Commission." Because protective coverage for professional judgments would benefit and protect investors in a number of ways—e.g., enhancing the quality of audits and financial statements and emphasizing to the investing community that judgments are an inherent part of financial statements and the auditing process—the proposed rule should meet this requirement.

## Responses to U.S. Treasury Department Advisory Committee Questions

Wayne Kolins

BDO Seidman, LLP

January 28, 2008

### **1. What can NASBA do to cause better alignment of rules and requirements (e.g. independence, CPE, etc.) across states and other regulators (to eliminate redundancies and confusion)?**

There is clearly a strong need for consistency across states and regulators in order to foster mobility within the accounting profession. In that regard, NASBA should continue to strive for uniformity with respect to educational and job-related licensing qualifications, professional standards, ethics, and continuing professional education. NASBA should also work to promote one mechanism that will regulate and enforce those standards.

### **2. What are the primary reasons for turnover at the senior accountant level and what is the firm and profession doing about it? How big of a factor is the busy season and compensation ... staff leaving for a better life/balance and comp/benefits? What can the Advisory Committee do to help with the retention issue? Please particularly address these questions in the context of retaining women and minorities.**

The primary reason for turnover involves quality of life. This relates not only to work/life balance but also the demands of the profession. Most high-quality, high-performing senior accountants are assigned to the larger and more complex engagements. Thus, the demands, pressure and, in many times, travel are usually greater for them. Add to these pressures the demands they face to meet CPE requirements and they are left with very little time to pursue personal interests. In short, they can "burn out". We also find that concerns relating to personal exposure to litigation have influenced some career decisions.

My firm has generally not found that senior accountants are leaving for better compensation. When they do, it is usually due to another public accounting firm (not private industry) offering them a large signing bonus or increased compensation. We rarely lose a senior accountant who took a job outside of public accounting because it paid more. Rather, they ordinarily chose that position because they felt they would not experience the same pressures.

It is difficult to determine what the Advisory Committee can do to assist with the retention issue because it primarily involves the firms changing their cultures and practices to address these issues internally. While we have not seen where these issues are unique to gender or minorities, BDO has begun two initiatives to address retention-- Our Flex Initiative and Women's Initiative, briefly described below. I suggest that the Advisory Committee recommend that other firms adopt similar initiatives.

*BDO Flex* – As noted above, the primary reason for our turnover is quality of life. We acknowledge that this is an issue facing *all* professionals and will be rolling out this program in

Spring 2008. This initiative is a business and career management strategy directed to the firm's continued growth and success in the 24/7, high tech, global work reality of today and tomorrow.

Our internal data, corroborated by external research, underscore that a desirable work/life fit (as each individual defines it) is critical to job satisfaction, productivity, and professional choices about where to work. The findings cut across lines of gender, family status and career status. This information, coupled with the competitive, swiftly changing business landscape, made it clear that flexibility is necessary to our firm's continued success.

Flexibility is a process for strategically managing and innovating how, when, and/or where work gets done. The goal is to help everyone in the firm achieve the optimal work/life "fit" that meets their personal needs and the needs of the business. Therefore, flexibility will look different depending upon the job and the person. These mutually beneficial solutions will involve a combination of formal arrangements as well as the use of informal day-to-day flexibility.

*Women's Initiative* – While I have noted that quality of life is the primary reason for our turnover and that it is not related only to women, we have identified that we need to do more to retain and develop the women within the firm. This initiative is a proactive effort on the part of my firm to attract and retain the most talented pool of professionals. Women are a significant portion of this pool, currently representing 55% of accounting graduates and half of the firm's client-facing workforce

**3. How many accounting graduates are hired each year for public company audit service? How many accounting graduates holding accounting graduate degrees are hired each year by your auditing firm? By the largest four auditing firms?**

BDO Seidman, LLP hires, on average 200 graduates with accounting degrees each year. Of those, 88% have bachelor's degrees and 12% also have master's degrees. We do not keep statistics on the percentage of graduates who work on public company engagements, but I would suspect that it represents a substantial percentage. I do not have the data regarding the four largest firms, although data was recently provided to the Advisory Committee in a report from the six largest firms submitted by the Center for Audit Quality.

**4. Does using a "para-legal" staffing model or different staffing tracks (e.g., professional school versus entrants from other educational processes) present any issues from your perspective? Why are the auditing firms not using a para-legal model now?**

The increasing complexity of the business environment and the move to more principles-based accounting and auditing standards will place even greater importance on the need for auditors to possess a high degree of analytical and critical thinking skills necessary to apply appropriate judgments. While, our firm and others in the profession have utilized para-professionals for certain relatively mechanical aspects of the audit and are likely to continue to do so in the future, the skills needed to apply significant auditor judgment will require a broad spectrum of undergraduate and perhaps even graduate training in technical accounting and auditing subjects.

## Treasury Advisory Committee Questions for the Record

Responses by Dennis M. Nally

Chairman and Senior Partner, PricewaterhouseCoopers, LLP

*Bill Travis has asked:*

**1. What can NASBA do to cause better alignment of rules and requirements (e.g. independence, CPE, etc.) across states and other regulators (to eliminate redundancies and confusion)?**

Together, NASBA and the AICPA have begun to address the inefficiencies of a multi-state licensing regime, including an effort that began last year to achieve 50 state 'mobility' for CPA licensees. NASBA reached out to the AICPA, state societies of CPAs and the national accounting firms to develop and share resources with individual state boards of accountancy and other state appointed and elected officials on the need for 'mobility' and statutory rules to achieve it in the individual states. These efforts have been positive and have helped to provide a more consistent application of standards in several states, but more can certainly be done. The complexity of moving people from state to state is made more challenging by those states that are less inclined to cooperate and set consistent standards, thus we hope the Committee will encourage NASBA and the states to engage constructively with federal regulators, and that all states and jurisdictions will work more collaboratively on a uniform approach that complements a move toward the convergence to a simple set of globalized, principles-based accounting standards.

**2. What are the primary reasons for turnover at the senior accountant level and what is the firm and profession doing about it? How big of a factor is the busy season and compensation ... staff leaving for a better life/balance and comp/benefits? What can the Advisory Committee do to help with the retention issue? Please particularly address these questions in the context of retaining women and minorities.**

A few years ago, PwC commissioned an independent study "*The value of the PwC professional experience: What employees gain by staying longer at the Firm, and why they leave.*" The study raises issues regarding whether there are consequences around leaving PwC at different career stages, the value of our people's experience here, as well as the major causes of turnover among our staff.

That study, conducted by the University of Southern California's Center for Effective Organizations, observed that the senior accountant level was the career point when recruiting from the external marketplace began in earnest. The study found that those who left the firm at this point in their careers often were seeking to restore balance in their lives, even in situations when they were enjoying their job. Professionals that left also often expected to be earning more in five years than if they were to stay. To complete the picture, the study also sought information on the reasons seniors stayed at the firm, and found that a principal reason was the opportunity to continue to develop and learn in a way that contributed to their professional growth.

Drawing on the study, and other information that corroborated the study's findings, PwC took a series of actions, which worked together to reduce materially the turnover rate at the firm. Those programs included the following:

- **Market Teams:** Approximately three years ago we began an initiative to create and support high-performing teams. The program's premise was that professionals who worked in smaller teams with a consistent structure would have a higher level of job satisfaction - partners and staff would be more closely connected and would be able to anticipate and react faster to their colleagues' issues and support each other in the process. Market Teams now have been rolled out to the entire Assurance practice, creating 132 teams involving 12,000 plus partners and staff. Increased job satisfaction, better work/life quality, and improved retention have resulted.
- *Turning Point* provides senior associates with a framework for coping with work and life demands, helping them manage the challenges of achieving self, career, family and community goals. Attendees emerge with a renewed commitment to the firm or become loyal alumni. After one year, turnover was reduced by 50% among those attending.
- **Everyday Coaching:** Two years ago, PwC introduced a consistent firmwide performance management process based on a set of core competencies. These competencies provide a common vocabulary and understanding of expectations and performance within each staff level. Beyond this tool, PwC began a culture changing initiative to embed teaching and delivering high quality feedback as a routine part of our everyday business practices. Our firmwide change management campaign titled "Everyday Coaching" included broad-scale communications, local coaching clinics, internal coaching videos as well as ongoing communications from firm leadership members.
- **Diversity of the Workforce:** The firm also recognizes the importance of attracting and retaining a diverse workforce to the firm. At PwC, we have done the following in this important area:
  - Having our Chief Diversity Officer report directly to our Firm's Chairman and being a part of the firm's core executive leadership team.
  - Maintaining an Office of Diversity, including senior subject-experts on the national team and local Diversity Leaders in the firm offices serving our 10 largest markets.
  - Selecting Diversity Partner Advisors for each of our lines of service (as well as one for our internal, non-client facing functions) to work with the Chief Diversity Officer on issues of importance to the recruitment and retention of minorities.
  - Having a national Director of Diversity Recruiting to broaden the scope of recruiting beyond traditional sources.
  - Maintaining a flexible working environment that enables the firm to respond to the demands of a client service business, while providing our partners and staff with control and influence over their own quality of life

- The launch of "Full Circle" helps high-performing employees who have left the firm for child or elder care responsibilities to stay engaged with firm business. This happens through ongoing connection with a designated mentor, as well as access to training programs and firm events. This program has successfully increased rehire rates among top performers.
- Incorporating inclusion, diversity and work/life values, awareness and practices as priorities into our people and business strategies
- Creating mentoring and networking initiatives to enhance leadership opportunities for women, minorities and gay and lesbian professionals
- Providing learning and education opportunities for leaders, managers and staff to better manage diversity and inclusion in their teams
- Providing consistent and frequent communications from national and local Firm leadership supporting the commitment to diversity

**3. What does your firm do to be successful that other smaller firms can learn from?**

We believe that the success of a firm is directly attributable to the quality of its people. The programs described above that we have created to enhance the experience of our people, and to enable the development of a balanced, diverse workforce have been rewarding for us and would have worthwhile application to all firms, small or large.

*GaryPrevits has asked:*

**4. How many accounting graduates are hired each year for public company audit service? How many accounting graduates holding accounting graduate degrees are hired each year by your auditing firm? By the largest four auditing firms?**

Our estimate is that the six largest firms hired just over 8,900 new accounting graduates into their audit practices in 2007. Estimating from data for five firms indicates that about 3060 of these hires have graduate degrees and 5840 have undergraduate degrees.

*Zoe-Vonna Palmrose has asked:*

**5. Does using a "para-legal" staffing model or different staffing tracks (e.g., professional school versus entrants from other educational processes) present any issues from your perspective? Why are the auditing firms not using a para-legal model now?**

As auditing has evolved over the last two decades, we have focused on making improvements in our approach which resulted in a reduction of the repetitive tasks performed by entry-level staff members.

About three years ago, our firm made changes to our staffing model, particularly with regard to some administrative positions to consolidate a variety of support tasks. As a result, one component of the PwC's Market Team structure is the introduction of new roles intended to assist with the effectiveness of managing the portfolio of engagements and supporting the teams. These new roles include a Project Manager, who oversees the portfolio prioritization process and deployment of staff resources, as well as a variety of operational and reporting responsibilities, and a Project Team Specialist who is responsible for many of the engagement's non-technical tasks, which removes much of the administrative and "non-audit" work from the professional audit staff.



**Question for the Record from the December 3, 2007, Meeting of the Treasury  
Advisory Committee on the Auditing Profession**

**Question to Witness, Mr. Jeffrey Steinhoff, Managing Director, Financial and Assurance Team, U.S. Government Accountability Office:**

How do you reconcile what seemed to be your relatively high opinion of audit quality with the increasing number of restatements of financial statements since the passage of the Sarbanes-Oxley Act?

**GAO Response:<sup>1</sup>**

In recent years, increased scrutiny on financial reporting and auditing has been widely seen as contributing to the increase in financial restatements and observations about improved audit quality. This increased scrutiny is rooted in demands for greater quality of financial reporting and auditing following the enactment and implementation of the Sarbanes-Oxley Act of 2002.

- In our 2006 report<sup>2</sup> on financial restatements which covered restatements from July 2002 to September 2005, we noted that
  - some industry observers told us that an increase in restatements was an expected byproduct of the greater focus on the quality of financial reporting.
  - a number of factors appear to have contributed to the increase in financial restatements including additional financial reporting requirements affecting public companies, especially management certification of financial reports; new requirements on company management and auditors related to internal controls over financial reporting; increased scrutiny by independent auditors; the new regulatory oversight process for audits; and the increased staffing and review by the SEC.
  - an apparently greater willingness on the part of some public companies to restate, without regard to the significance of the event.
- While we did not assess audit quality, our recent report on concentration in the public company audit market<sup>3</sup> made a number of key observations regarding audit quality.

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<sup>1</sup> GAO response provided by Ms. Jeanette M. Franzel, Director, Financial Management and Assurance Team, U.S. Government Accountability Office.

<sup>2</sup> GAO, *Financial Restatements: Update of Public Company Trends, Market Impacts, and Regulatory Enforcement Activities*, GAO-06-678 (Washington, D.C.: July 24, 2006).

<sup>3</sup> GAO, *Audits of Public Companies: Continued Concentration in the Audit Market for Large Public Companies Does Not Call for Immediate Action*, GAO-08-163 (Washington, D.C.: January 9, 2008).

- Market participants and public company officials commenting on audit quality generally noted that it had improved in recent years.
- More than 70 percent of public company survey respondents cited aspects of improved audit quality which they associate with increased audit time by audit staff, senior partners, and experts and the additional audit work associated with the new reporting requirement on internal control over financial reporting.
- All of the largest firms and over 80 percent of the midsize and smaller firms responding to our survey said that, since 2003, it has been harder to maintain audit quality. This widely held view likely reflects the significant changes in the auditing environment since 2003 and the heightened demands facing the profession as audits have become more complex, accounting and auditing requirements have expanded, and the PCAOB's inspection program has been implemented. Together these changes and demands have increased emphasis on audit quality and also likely contributed to a belief that the "bar has been raised" for audit quality.
- Although the number of company restatements had been increasing for several years, a recent report indicates that the number companies that restated in 2007 were less than in 2006.<sup>4</sup>

With the greater scrutiny and related significant changes in the financial reporting and auditing environment in recent years—much of which is associated with management and auditor responses to various provisions of the Sarbanes-Oxley Act—it is neither surprising nor inconsistent that financial restatements have increased during a period when many knowledgeable observers believe that audit quality has improved.

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<sup>4</sup> Glass Lewis & Co., *The Tide is Turning* (January 15, 2008).

February 1, 2008

**Responses to Follow-up Questions  
Treasury Advisory Committee on the Auditing Profession  
James S. Turley, Chairman and CEO, Ernst & Young LLP**

**1. *What can NASBA do to cause better alignment of rules and requirements (e.g. independence, CPE, etc.) across states and other regulators (to eliminate redundancies and confusion)?***

NASBA has an important and valuable role to play in promoting the consistency of rules, requirements and standards across state lines. In the modern economy, few clients or engagements are limited to one state, and inconsistencies can create real confusion. The interests of the investing public are best served when clear rules are consistently applied. This principle should be reflected in the Uniform Accountancy Act and accompanying model regulations. NASBA should encourage its member boards to implement those provisions in a way that assures the greatest possible uniformity. In particular, NASBA should work toward the development and implementation of consistent CPE requirements. In the latter regard, perhaps the best approach would be to require a CPA to fulfill the CPE obligations in the state of his or her principal place of business, and then deem the CPA to be compliant in other states where the CPA maintains a reciprocal license or provides services under the new mobility system.

**2. *What are the primary reasons for turnover at the senior accountant level and what is the firm and profession doing about it? How big of a factor is the busy season and compensation ... staff leaving for a better life/balance and comp/benefits? What can the Advisory Committee do to help with the retention issue? Please particularly address these questions in the context of retaining women and minorities?***

Looking at the data available to us, the primary reasons senior accountants leave the firm are to reduce the number of hours worked and to improve work-life balance. In a 2006 survey on career aspirations sent to current employees and alumni, we asked current employees what would make them consider leaving the firm and asked alumni what factors contributed to their decision. In response:

- 75% of currently employed seniors cited "current work life balance" and a similar percentage cited "number of hours."
- 61% cited "long term compensation" as an issue.

Alumni who left as seniors reported on the factors contributing to their decision to leave:

- Fewer hours - 53%
- Compensation package - 44%
- Feeling of burnout - 44%

- Higher salary - 43%

Half of our alumni who left as seniors went into an internal accounting/auditing position in another industry and 11 percent pursued a non-accounting/auditing career. Workload and the unpredictable nature of our work are issues our profession has faced for many years. In recent years, globalization and technology have combined to create a 24/7 environment, one in which our clients expect consistent, seamless high quality service worldwide. At the same time, people's values are shifting when it comes to the relative importance they place on work, family, and other important factors in their lives. A strong economy and changes to the profession have created many employment options for qualified accountants.

As a senior (or manager), it is not unusual for an individual to be offered a 15% to 20% pay raise to work in corporate America, as well as public companies having the ability to offer stock-based compensation.

Because our people – our most precious asset – have so many career choices, it is inevitable that many will leave at some point in their careers. Therefore, it is also imperative that we create life-long relationships should our people leave and later choose to return.

- From a recruiting perspective, we are consistently rated by college students as one of the most desirable of all employers. We're building a pipeline of diverse talent by supporting scholarship and mentoring programs and working closely with universities, as we do with clients, to understand their challenges and communicate the changes in our profession.
- To retain our professionals, we work hard to foster an inclusive and flexible work environment, and to make our firm known as one of the absolute best places to work.
- We've made inclusiveness a priority at Ernst & Young. We want everyone to feel they are included in our business, and that they can build successful long-term careers regardless of their gender or cultural background.
- Globalization demands we have a diverse work force, full of different perspectives, experiences and ways of thinking, collaborating in a way that is inclusive of ideas, regardless of culture, gender, sexual orientation or other differences.
- To meet the personal needs of our professionals looking for developmental opportunities within the firm, and to honor our client promise of having the right people in the right place at the right time, globally Ernst & Young has 2,160 people on international assignments. These assignments provide our people with global viewpoints through the vital experience of working across countries and cultures. At its core, career mobility builds our people's technical and industry knowledge across our global organization, with skills often transferring across borders, within industry sectors and across service lines and business units. Career mobility is an important factor in the overall personal and career development and satisfaction of our people.

- As a private firm that does not offer stock options and other creative compensation options, we offer a broad set of tangible and intangible benefits that support and motivate our people to do their best on and off the job. In appreciation of each individual's contribution to the firm's success, our Total Rewards package — compensation, benefits, time off, career development, an inclusive and flexible work environment, corporate social responsibility and other programs— plays a significant role in creating the total value of working at EY.
- Finally, we invest in the growth of our people throughout their careers by creating world-class learning and development opportunities within the firm. We believe this investment in our people builds the capabilities to execute the firm's strategy and differentiates its brand in the marketplace. We have a three part strategy for learning that builds on the synergy between classroom learning, experiences and mentoring. The firm's learning and development operation delivers on a scale comparable to and probably exceeding that of the world's largest universities.

EY's commitment to creating a flexible and inclusive work environment is real and has been recognized consistently year after year by *Fortune*, *Working Mother* and *Diversity Inc* magazines, to name a few. In 2007, EY was inducted into *Training* magazine's exclusive Hall of Fame, marking its placement in the Top 10 of *Training*'s Top 125. Our flexible and inclusive work environment, coupled with our rich development culture, is a key factor in why people choose to return to Ernst & Young. To additionally highlight the value of our flexible environment, the career aspirations study mentioned above revealed that "boomerangs" (people who have left and rejoined the firm), are 2.5 times more likely to be on a formal flexible work program than someone who has never left the firm.

Ernst & Young recently conducted a survey of current and former employees that showed that the longer one stays at our firm, the better one's chances of ultimately reaching a top job, the greater one's potential lifetime earning power, and the higher one's job satisfaction. (See attached Career Value Study).

To help with the retention, the Committee may consider:

- Taking a profession-wide look at generational, women's, and minorities' issues and their specific impact on attracting and retaining the best and the brightest to the profession.
- Promoting the prospects of a career in public accounting as demonstrated in the Ernst & Young Career Value Study mentioned above and the long-term benefits of staying in the profession.
- Creating a reliable source for benchmarking turnover trends across the profession.

**3. *What does your firm do to be successful that other smaller firms can learn from?***

Firms of many sizes have enjoyed considerable success over the years. Our firm does not have a corner on the best ideas or tactics, but a few recommendations to smaller firms would be:

- Do not ever take for granted your firm's focus on high-quality work and serving the public interest. Keep this obligation top of mind through words and actions. This is even more important during times of market growth opportunities when it is easy to get distracted and take your eye off of the ball.
- Be actively engaged in the profession through participation in activities and programs of the AICPA, the Center for Audit Quality, the state boards of accountancy, etc. The collaboration and sharing will improve the profession, your firm, and your people. We can be strong competitors and yet work together to improve the profession.
- Embrace change, such as the increased regulation of our profession. That regulation is a necessary part of providing investors and the public with confidence in our profession and appreciation for the value of our services.
- Business and financial markets are becoming more and more global. Globalization is another area for embracing change. Keep up to date on international developments and invest time and resources in preparing for change that convergence will bring to us.
- Be active in all of the issues affecting our profession, including governmental and public policy matters.

**4. *In your submitted written statement you refer to human resources subjects regarding recruitment. I would appreciate an elaboration of your comments about the recommendations you made, in particular under item one (page 5). Therein your comments appear to be directed toward program content and subject matter, the means of candidates acquiring experience and the evolving 150 hour requirement, which appears to be supported by a growing supply of master's degrees awarded.***<sup>1</sup>

Ernst & Young supports the 150 hour rule. As a general matter, since 1997 we have only hired people for the audit practice who are qualified to sit for the exam in their jurisdiction. The only exception is a small number of hires through Ernst & Young's "Your Master Plan" program, which allows non-accounting business majors from diverse backgrounds to earn a master's degree in accounting from the University of Notre Dame or the University of Virginia while working for Ernst & Young.

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<sup>1</sup> AICPA Supply and Demand Study 4 (2005): Accounting Masters Degrees Conferred 2000 to 2004 (Y2000: 7,980; Y2001: 8,700; Y2002: 9,700; Y2003: 12,655; Y2004: 13,340)

**5. How many accounting graduates are hired each year for public company audit service? How many accounting graduates holding accounting graduate degrees are hired each year by your auditing firm? By the largest four auditing firms?**

The six largest firms provided detailed hiring data in our “Report of the Major Public Company Audit Firms to the Department of the Treasury Advisory Committee on the Auditing Profession.” The specific hiring data requested is repeated in the table below.

	FY 2005	FY 2006	FY 2007
<b>Average Total Hires</b>	1910	2135	2127
<b>Average # of Baccalaureates</b>	1,175	1322	1275
<b>Average # of Masters Degrees</b>	596	695	657
<b>Average % Audit Practice Hires</b>	68%	66 %	64%

**6. Does using a “para-legal” staffing model or different staffing tracks (e.g., professional school versus entrants from other educational processes) present any issues from your perspective? Why are the auditing firms not using a para-legal model now?**

One of the most effective ways to develop public company auditors at the partner and executive ranks is through experience and on-the-job training. The firms need to hire a sufficient quantity of entry-level auditors to produce the necessary quantity of partners and executives over time. It is the training and mentoring that younger professionals receive while participating in audits that make them successful at the partner or executive level.

Entry-level auditors are expected at the outset to perform meaningful audit procedures as part of audit engagement teams. Given the nature of audits and the complex environment in which we perform our work, it is important that entry-level auditors gain substantial experience in the exercise of sound professional judgment and decision-making while working directly with more experienced auditors and executives, and gaining insights and feedback from them. Such experience, gained from participating in many different engagements over time, enables auditors to improve their decision-making capabilities and exercise of sound professional judgment. As we move toward accounting standards, such as IFRS, that have less detailed rules, we believe it will be even more important for auditors to

start honing their professional judgment early in their careers and continually improving it throughout their professional development. In short, the ability to deploy “para-professionals” is perhaps less of an opportunity in our profession than in the legal profession.

Our firm continues to look for ways to perform highly-effective audits while improving the efficiency of our work. We are making some use of lower cost professionals and “para-professionals” to assist in the administration and coordination of audits and are piloting the performance of certain routine or mechanized audit work.





 **ERNST & YOUNG**  
*Quality In Everything We Do*

# Career Value at Ernst & Young

Supporting People's Growth and Success

# METHODOLOGY

Data for the study were collected from multiple sources, including archival data, interviews with current and former employees, and three on-line surveys targeted to current employees, Ernst & Young alumni, and boomerang employees. In total, data from all sources included almost 50,000 current and former Ernst & Young client-serving professionals.

While this study focused on information gathered from our client servers, we believe that many of the findings also apply to our non-client serving (Core Business Services) professionals as well.

Source: "Career Management in a Knowledge-Based Industry," Professor Benson Rosen, University of North Carolina (2006).

# INTRODUCTION

Ernst & Young embraces the idea that what we do truly matters: to investors and regulators, to our clients and their employees, and to the communities we serve. Therefore, it is imperative that we have the right people—people not only with the requisite skills, but with the highest standards of integrity, professionalism, and sense of public purpose. We also subscribe to the notion that if we put our people first, quality work and growth will follow. As part of the firm's People First philosophy, we talk about a two-way commitment between Ernst & Young and our people: that is, Ernst & Young will invest in our people's careers and in turn our people will commit to do their best for the firm and our clients.

To improve our understanding of what people desire and expect from a career at Ernst & Young, we recently commissioned a study to examine the needs, wants, and career aspirations of our client serving employees, alumni, and rehires (a.k.a. boomerangs). The study, conducted by Professor Benson Rosen, Ph.D., professor of Organizational Behavior/Strategy at the University of North Carolina, and his associates, included data from almost 50,000 current and former Ernst & Young professionals in the United States and Canada. Through this study we specifically sought to learn why people come, stay, leave, and return, along with the value of a career at Ernst & Young.

## Top Level Findings

Ernst & Young has nearly 30,000 people in the U.S. and Canada. While the study clearly showed that career aspirations are personal, and that individuals have their own career needs, wants and priorities, it also revealed some key common themes as listed in the box at right.

By studying and gaining a better understanding of these themes, our intent is to better focus our efforts on attracting, developing, and retaining high-performing professionals.

### We learned:

- The longer one stays at Ernst & Young, the better one's chances of ultimately reaching a top job, the greater one's potential lifetime earning power, and the higher one's job satisfaction
- The most valuable professional development happens at the manager and senior manager level
- While career wants and needs are personal, some common patterns emerged that change based on the stage of a person's career
- People want frequent, personal conversations about their careers, their position on their career path, options, and how to progress

# CAREER NEEDS, WANTS, AND ASPIRATIONS

Ernst & Young attracts great people who have many career options available to them when they join us. Understanding what attracts people and their goals while they are here is important to maintaining and enhancing our position as an employer of choice for both current and potential employees. The study found agreement among current employees, boomerangs, and alumni on the main reasons people are attracted to Ernst & Young. These include:

- Ernst & Young's culture and people
- Ernst & Young's reputation in the market
- Learning and development opportunities over one's career
- The opportunity to attain early career goals (Big Four experience, CPA/CA requirements, building technical expertise)
- The nature of the work

Over time, however, as their individual life circumstances change, so do our people's career needs and aspirations. Personal career strengths and interests become clearer and personal situations evolve. While individual needs are unique, the study helped us see several patterns in career wants and needs. For example:

- Staff, in the early stages of their careers, desire personal connections, particularly with more senior personnel, and challenging work
- Seniors and managers are more concerned with work/life balance and their total compensation
- Senior managers' concerns over promotion and career prospects take precedence, along with a renewed interest in strong relationships and connections

The study also indicated that people find the following experiences most valuable in an Ernst & Young career:


- On-the-job training
- Exposure to different clients
- Technical and non-technical training
- Informal mentoring
- Working with a diverse group of colleagues

From this information we more clearly understand that, in order to retain and enable people to perform at their best, we must continually strive to align the needs of the firm with the changing career needs and aspirations of our people.

Ernst & Young is a top-rated learning organization\* and learning and development opportunities are a key reason people are attracted to us. Given the rapid pace of learning in the first few years of an Ernst & Young career, one might think that learning and growth would slow over time. Actually, the opposite is true: In the study, our alumni said **their most valuable professional development occurred when they reached the manager and senior manager levels.**

**“I have different needs and desires now than when I started. I hope to stay as long as I can balance my work/life goals, feel I am being treated fairly, am challenged, can work with good people, and am getting fairly compensated. As senior manager I am evaluating whether there is a long-term future for me here. This is a career significant driver for me now, but wasn't even a consideration when I was a staff or senior.”**





People have uniquely personal and evolving career needs; however, we did discover definite patterns in what people need based on their stage in their career.

# A LONGER VIEW OF A CAREER

The future is not always clear and it is easy to put short-term priorities ahead of long-term interests. Through the study, including those alumni who shared their experiences after leaving the firm, we now have a better understanding of the long-term value of an Ernst & Young career:

## **All that learning and experience pays off.**

For those who desire to achieve a top job (partner/principal, CFO, president, vice president), study results suggest that the level at which one leaves Ernst & Young is predictive of the future likelihood of obtaining a top job.

For example, those at the senior level have a 15 percent chance of obtaining a top job sometime in their career after leaving Ernst & Young, however:

- Staying until the manager level means someone is nearly twice as likely to obtain a top job than someone leaving as a senior
- Staying until the senior manager level means someone is five times more likely to obtain a top job than someone who leaves as a senior

There is also a long-term salary advantage associated with the Ernst & Young career experience. The study examined the current earnings of alumni who left at various levels. For people with the same number of total years in the workforce, both inside Ernst & Young and elsewhere, on average, individuals who left as a:

- Manager earn 45% more than those who left as staff
- Senior manager earn 47% more than those who left as managers

## **The bottom line?**

The longer a person stays with Ernst & Young the better off they will likely be—both financially and in terms of achieving a “top level” job. (Of course we sincerely believe that it is not necessary to leave Ernst & Young for a very attractive “top job”: A partner/principal position in Ernst & Young is among the finest of these opportunities.) And while some join Ernst & Young with short-term goals, such as becoming a CPA or CA and acquiring Big Four experience, the study showed it’s things like leadership skills, client exposure, solid technical training, and relationships with colleagues that provide the most significant career value.

**The longer one stays at Ernst & Young,  
the better one's chances of ultimately  
reaching a top job and the greater one's  
potential lifetime earning power**





# THE IMPORTANCE OF RELATIONSHIPS

Alumni and boomerangs (rehires) both stress the importance of relationships in their career decisions. For example, feeling a lack of connection is often a key predictor of departure. Additionally, boomerangs tell us that one of the main reasons they return is the caliber of their Ernst & Young colleagues. (Approximately 25% of the experienced people we hire each year are boomerangs returning to the firm.)

A few key findings:

- 40% of our boomerangs return in a year or less; an additional 29% return within two to three years
- The top two reasons alumni left Ernst & Young were 1) feelings of “burnout,” and 2) a desire to work fewer hours. Interestingly though, the research shows that only about 57% of those who leave Ernst & Young report working less than 50 hours per week in their new role
- The top reasons people return to Ernst & Young include the high caliber of their colleagues, the stimulating work, the firm’s flexible work environment, and the career advancement opportunities
- The process of leaving and returning to Ernst & Young gave boomerangs a greater sense of freedom to explore changes in their working conditions. To validate this point, we examined the percentage of boomerangs on flexible work arrangements (FWAs). While FWAs are only one type of flexibility, we found that boomerangs were 2.5 times more likely to be on an FWA than non-boomerangs.

Building a culture of inclusiveness and flexibility, where all people feel welcome and are able to meet their personal and professional goals, remains one of Ernst & Young’s highest priorities. Our goal is to build relationships with each of our people; relationships that are built one conversation at a time. It is our hope that by commissioning this study we have laid the foundation for many conversations to come: conversations that address individual needs, identify opportunities, and strengthen relationships throughout the firm.





**Our alumni reported that  
their **most valuable professional  
development** took place  
when they reached the  
**manager and senior manager levels.****

# LESSONS LEARNED

Many lessons can be drawn from the information provided in the course of this study—some are new and some simply reinforce those we already know. We will continue to use the data gathered to influence decisions that impact our people and to guide Ernst & Young's people strategy. A few key lessons to immediately take away:

- Building relationships with people is key to attracting them, helping them grow, and encouraging them to stay
- While everyone has individual career needs and aspirations, certain distinct patterns can be seen that correlate to the phase of a person's career. Understanding how people's career needs evolve through the course of their careers may lead to higher retention and more fulfilled employees
- People want regular and realistic dialog about their individual career prospects, not generic career path information that is obvious
- Boomerangs possess a wealth of knowledge that can be applied to current employees, such as asking about their needs and being creative in developing working conditions, flexibility options, etc.

## Start a Conversation

- For more information on this study, please contact Jeffrey Merrifield, Ernst & Young Manager of Research and Business Insights, at [jeffrey.merrifield@ey.com](mailto:jeffrey.merrifield@ey.com)
- For more information on a career at Ernst & Young, please visit the EY careers Website at [www.ey.com/careers](http://www.ey.com/careers)
- If you are an Ernst & Young employee and wish to further discuss your career needs and aspirations, please see your Counselor or Business Unit leader







In summary, it is clear from the survey that relationships, learning, and growth create the greatest career value for our people—value that grows over the course of a career at Ernst & Young.

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**George S. Willie, Managing Partner, Bert Smith & Co.**  
**Advisory Committee on the Auditing Profession**  
**Questions for the Record**  
**December 3, 2007**

**What can the Advisory Committee do to enhance the recruitment of minorities to the Profession?**

The profession must be seen as a viable career path for minority students. In order for this to happen, there will have to be a change in culture. We must raise awareness that accounting is a profession with potential for minorities. One organization or agency cannot do it alone. There must be a unified, national outreach effort to be effective and enhance the recruitment of minorities to the accounting profession.

As noted in my testimony, we need to do a better job of reaching into minority communities in order to expand the pipeline. Some initiatives that I would ask the Advisory Committee to consider recommending include:

- Encourage the development of a national public service advertising campaign focused on raising awareness of the profession to minority students by contributing federal funding and support to develop radio, print and television public service announcements (PSAs)

This outreach could be facilitated nationwide through partnerships with various groups/organizations including the US Department of the Treasury, National Association of Black Accountants (NABA), INROADS, state CPA societies, AICPA, Association of Latino Professionals (ALFA) in Finance and Accounting and others, rather than each group creating outreach programs and initiatives of their own.

In addition, the organizations that are dedicated to serving minorities such as ALFA and NABA, should establish significant outreach programs with universities and colleges with large minority student populations.

Other potential recommendations to promote the public company auditing profession to minority students (and their families and support networks) are:

- Encourage establishment of a mentor program which will connect accounting students with mentors and also incorporate family interaction
  - Expansion of current mentoring programs could include a virtual online mentoring program from a national website with assistance of federal funding (connected to the above-mentioned public service campaign) that introduces students to professors and professionals in accounting who volunteer to answer questions via email, online blog etc. about accounting courses, the CPA Exam, the audit profession etc.

- Help extend the reach/awareness to minorities by encouraging the profession to become more visible at community colleges, as well as four-year institutions.
- Enhance outreach at the high school level in predominately minority high schools across the country.
- Support creation of an advocacy program that will in turn help establish a branding/public relations program by featuring/focusing on individuals who are already successful in the profession and encourage their advocacy to promote the profession nationwide.
- Continue support of PhD initiatives currently in place by contributing federal funding to the AICPA Minority Doctoral Fellowship Program, the PhD Project and the AAA
- Diversity Section.