July 3, 2008

Co-Chairman Arthur Levitt, Jr., Co-Chairman Donald Nicolasen
Advisory Committee on the Auditing Profession (ACAP)
Office of Financial Institutions Policy, Room 1418
Department of the Treasury
1500 Pennsylvania Avenue, NW.
Washington, DC 20220

Re: ACAP Draft Report Dated May 5, 2008 and Subsequent Addendum

Dear Co-Chairmen Levitt and Nicolasen:

The Committee on Corporate Reporting (“CCR”) of Financial Executives International (“FEI”) appreciates the opportunity to provide its views on the Draft Report published May 5, 2008 and subsequent Addendum by the Department of Treasury’s (“Treasury’s”) Advisory Committee on the Auditing Profession (“ACAP” or the “Committee”).

FEI is a leading international organization of 15,000 members, including Chief Financial Officers, Controllers, Treasurers, Tax Executives and other senior financial executives. CCR is a technical committee of FEI, which reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations. This comment letter represents the views of CCR, and not necessarily those of FEI or its members individually.

CCR supports the efforts of the ACAP in developing recommendations designed to enhance the sustainability of a strong and vibrant public company auditing profession, and in support of Treasury’s mission to promote conditions for prosperity and stability. We also appreciate that ACAP’s goal, like that of the SEC Advisory Committee on Improvements to Financial Reporting (CIFiR), is broad and daunting, but necessary.

Importantly, CCR recognizes the role of our own members, preparers of financial reports, in providing complete, timely, and reliable financial information. We concur in the need for focus on the sustainability of the profession that audits this information.

Attached you will find our detailed views on certain matters addressed in ACAP’s May 5 Draft Report and subsequent Addendum.

Members of CCR would be pleased to meet with the Treasury staff or members of ACAP to discuss these issues in more depth and to answer any questions you may have. Please contact Christine DiFabio, Vice President, Technical Activities at FEI cdifabio@financialexecutives.org 973-765-1071, if you would like to arrange such a meeting or have any questions.

Sincerely,

Arnold C. Hanish
Chair, Committee on Corporate Reporting
Financial Executives International
FEI Committee on Corporate Reporting  
Comment Letter on Draft Treasury ACAP Report and Subsequent Addendum  
July 3, 2008  
ATTACHMENT: Detailed Comments

DRAFT REPORT DATED MAY 5th, 2008

Human Capital (including recruitment, retention, training and education)

CCR supports ACAP’s goal of strengthening human capital in the audit profession; the stronger and better trained that human capital is within the audit profession, the better services we will receive as their clients, and the stronger the pipeline will be from audit firms to companies. Although retention at audit firms is an important goal, there will always be a natural pipeline of some segment of the audit profession moving to take jobs with public companies (e.g. as CFO or Controller) and we believe that is a healthy movement.

1. We support ACAP’s recommendation to implement market-driven and continuously evolve curricula for accounting students, with concurrent updating of certification exams and relevant professional and ethical standards. We further suggest even more emphasis that the curricula regarding International Financial Reporting Standards (IFRS) needs to be enhanced immediately in light of the continuing move to international convergence, including the expected issuance by the SEC this summer of a roadmap that may specify an option - or a requirement - for U.S. companies to report in IFRS.

2. We also support ACAP’s recommendation to improve the representation and retention of minorities – [we suggest broadening this recommendation to expressly include women as well as minorities] - in the auditing profession to promote a diverse workforce.

3. We support ACAP’s recommendation to ensure a sufficiently robust supply of qualified accounting faculty - including not only those with PhDs (i.e., considered “Academically Qualified” to teach, or “AQ”), but also those who are professionally qualified to teach (known as “PQ”) by means of their real-world experience. FEI has promoted in its member newsletter and on our website and magazine a number of programs to encourage more professionals to teach, such as the American Accounting Association’s (AAA) programs for professionals interested in the PQ designation, and the American Association of Collegiate Schools of Business’ (AACSB’s) “Bridge Program.” Additionally, we are particularly intrigued by ACAP’s suggestion of encouraging cross-sabbaticals for professors and accounting professionals, and encourage further exploration of that idea. Our research foundation, the Financial Executives Research Foundation (FERF) has a mission of engaging in practical research of interest to financial professionals, if you would like to meet with FERF leadership to discuss this or other issues, please let us know.

We note that under the ‘Human Capital” heading of the Draft Report, the committee also recommends development of certain databases and initiation of certain studies relating to education. We urge the committee to consider the incremental cost-benefit of those efforts vs. existing databases and recent studies, in terms of the scope of information already available.

Firm Structure and Finances

1. Although we share the committee’s concern about the need to “strengthen auditing firms’ fraud detection and prevention skills” we are not at this time in agreement that there is a need for a ‘new national center’ on fraud, and believe careful consideration should be given before acting on ACAP’s recommendation to launch such a center.

There are numerous highly qualified organizations that already have expertise in this area, including the American Institute of Certified Public Accountants (AICPA) as well as the Association of Certified Fraud Examiners (ACFE), Institute of Internal Auditors (IIA), Committee of Sponsoring Organizations of the Treadway Commission (COSO), and others. It does not appear that sufficient consideration was given to these existing resources, the ACFE in particular, which is not even mentioned in the Draft Report.
Additionally, we note that the larger audit firms have developed, particularly post-Enron, forensic audit practices, which provide specialized services to supplement audits, as well as full forensic audit work on special engagements and investigations.

We believe ACAP and others should consider if the existing professional associations and forensic audit practices which focus on fraud currently fulfill – or with modest modifications could better fulfill - the broader aims of ACAP with respect to fraud prevention and detection. Such efforts could better leverage existing investments and benefits, rather than setting up a whole new organization with potentially significant new costs to achieve the same purpose. For example, perhaps there could be better coordination and communication of best practices, not only within the public accounting profession but with financial executives, management accountants, and internal auditors, recognizing some may believe there is currently a silo approach based on the role a person plays in an organization or the professional association to which one belongs. However, we are not in agreement that there is a need to form a new national center to address these issues at this time.

Separately, we note the Draft Report also recommends that ACAP “encourage the PCAOB and the SEC to clarify in the auditor’s report the auditor’s role in detecting fraud under current auditing standards and further that the PCAOB periodically review and update these standards.” We do not believe further standard-setting is required in this area at this time. However, if the SEC or PCAOB do proceed with standard-setting relating to fraud prevention, detection, and reporting, we suggest that any recommendation should provide sufficient flexibility to consider various approaches that can be taken by the company and its auditors relating to fraud prevention and detection and the cost-benefits of those various approaches, without imposing a one-size-fits-all approach. In particular, we believe imposing a forensic audit annually would be overkill. As a practical matter, forensic techniques are becoming more embedded in routine audits.

2. We support actions to increase the mobility of CPA certification throughout the U.S., and we strongly support the recommendation to “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.

3. We suggest caution with respect to ACAP’s recommendation that “the PCAOB and the SEC, in consultation with other 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 members with full voting power to firm boards and/or advisory boards with meaningful governance responsibilities to improve governance and transparency at auditing firms.” We are not convinced of the practicability of ACAP’s suggestion for independent board members of audit firms, given the current structure of audit firms, and we share the concern of some who have testified before ACAP as to the potential liability any such independent board member would face. We believe time spent on other recommendations offered by ACAP may have more practical and near-term results.

4. We would not object to clarification from the SEC that every change in auditor must be reported in a Form 8-K. However, we are concerned about what is meant by ‘characterize’ such changes appropriately. There is a need for public companies and for audit firms to protect confidential matters from competitors and others, and we urge caution on any requirement that would compromise the companies’ (and in turn, shareholders’) and audit firms’ interests.

Concentration and Competition

1. We concur in spirit with the goal of reducing barriers to the growth of smaller audit firms. However, we note that as a practical matter, particularly for companies that are members of CCR, which are Fortune 500 companies international in scope, there is often a need to use a Big 4 firm for expertise and global reach. We strongly support ACAP’s recommendation (recommendation 1a) that government and private sector organizations should strive to include representatives of smaller audit firms in committees and public forums. However, we are not certain that there would be a net benefit to any requirement, (suggested by ACAP in recommendation 1b), to require disclosure by public companies in their annual reports and proxy statements, of any provisions in agreements with third parties that limit auditor choice,
due in part to the substantive reason we noted above (expertise and global reach) that sometimes drives (and limits) audit firm choice, understandably so.

2. To stave off instability in the system, we fully support the recommendation to “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.” We believe it would be devastating if another audit firm, particularly a large audit firm on whom a significant portion of the capital markets relies, were to meet the same fate as Arthur Andersen and go out of business.

3. Another recommendation we concur with in spirit is the recommendation that the PCAOB develop key indicators of audit quality and effectiveness, the publication of which could benefit, among others, audit committees in selecting audit firms. However, we are not certain of the usefulness for this purpose of some of the financial performance metrics referenced in the report used in other jurisdictions, such as the proposal win rate and revenue and profit per partner. We also caution that any such audit quality factors not unnecessarily divulge confidential information about audit firms or their clients. We do agree, however, that if the PCAOB considers developing such audit quality factors, that it be done, as ACAP recommends, “in consultation with auditors, investors, public companies, audit committees, boards of directors, academics, and others.”

4. We support ACAP’s recommendations to promote the understanding of, and compliance with, auditor independence requirements among auditors, investors, public companies, audit committees and boards of directors.

5. Regarding ACAP’s recommendation to “Adopt annual shareholder ratification of public company auditors by all public companies,” we believe the practical ramifications of this should be explored, to not unduly limit the ability of audit committees to perform their job in making an informed choice of an audit firm on a timely basis.

6. We support ACAP’s recommendation to “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.” However, the recommendation appears to imply the PCAOB has not already been working toward regulatory collaboration and coordination, and in recent months in particular the PCAOB has made several announcements and convened a roundtable concerning increased efforts in this area. We encourage efforts among all regulators to work toward convergence, but we also appreciate there may be differences in local jurisdictions, including in the roles of audit firms and local regulators, and the PCAOB, under the oversight of the SEC, needs to maintain sufficient latitude on these decisions.

ADDENDUM TO DRAFT REPORT

1. Auditor’s Report

Although we concur in spirit with ACAP that it would be worthwhile for the PCAOB to further explore potential changes to the auditor’s reporting model (including the form and content of the auditor’s report), we do not necessarily support ACAP’s recommendation that the PCAOB engage in a ‘standard-setting initiative’ on this matter at this time. With so many significant changes being driven by the SEC and FASB (e.g., XBRL, a potential move to IFRS, fair value reporting), we believe the PCAOB should keep apace of these developments, but adding into the mix a major change in the auditor reporting model (e.g., the suggested change from the current ‘pass-fail’ system to a more finely graded system) can add even more stress to an already stressed system.

We agree it is always worth continually improving systems and products, and the auditors’ reporting process is no different in that regard. However, caution should be exercised before embarking on rulemaking in this area, to be sure any changes enhance confidence in the system, rather than cause confusion or needlessly detract from investors’ confidence.
A lesson may be taken from the recent market turmoil, in which some allege certain methods of measuring fair value for illiquid instruments may have contributed to a procyclicality in the downward spiral in value of certain instruments (e.g., by driving liquidations of portfolios that fell below a certain price level, when governing terms of certain investors required such liquidation upon such price moves). Similarly, the grading systems of rating agencies have been questioned, and the SEC recently voted to release proposals in which one option offered to rating agencies is to issue a new grade (e.g., DOT-SF for structured finance products), to help explain the differential characteristics of structured finance products. In each case, the pricing or rating system may influence economic activity in a way that some believe is consistent with the underlying risk and quality of investments, and some say understates or overstates that risk and quality. We may want to proceed with caution before changing the grading scale of the auditor’s report in a way that would imply more precision than there really is; that could possibly backfire by increasing, not decreasing, the ‘expectation gap.’

2. Engagement Partner Signature

We are not convinced, as a practical matter, that having the engagement partner publicly sign his/her name to the auditor’s report would enhance audit quality, and indeed there could be offsetting negative consequences of such a move.

Specifically, we are very concerned that such a requirement, although it may not enhance the legal liability of the partner per se, may cause the partner to become excessively conservative, and seek bright lines in rules and second (and possible third) opinions from the national office, before being willing to sign their name on a publicly issued audit opinion.

FEI strongly supported the CEO-CFO certification requirement and financial officer code of ethics requirement in the Sarbanes-Oxley Act. Some argue there should be a parallel requirement for signatures of engagement partners on the audit.

In concept, we support initiatives that encourage accountability of auditors. However, we believe other measures to enhance audit quality and strengthen the audit profession (other than engagement partner signature) deserve attention at this time.

3. Transparency of Audit Firms

We agree in concept that audit firms should make more information publicly available about their financial condition, and publish indicators of audit quality. However, considering testimony received by the committee, we are sensitive to concerns that the disclosure of such information not expose the audit firms to enhanced risk at the hands of the plaintiff’s bar, given they already are at risk of catastrophic liability.

We note ACAP has cited as an example of one such ‘transparency’ report, the European Union’s Article 40 Transparency Report, 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. We also note ACAP recognized that the U.K. requires audit firms to publish 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.

We believe further consideration should be given by convening all interested parties (investors, public companies, audit firms, board members, government agencies) to explore further what type of information would benefit the public, balancing potential confidentiality concerns of the audit firms, with an eye toward possible convergence with the EU Article 40 and/or U.K. requirements. At the same time, we respect that ACAP has received testimony that the EU 40 and U.K. disclosure models may not transfer well to the U.S., given the different liability regime. Perhaps an impartial party like the SEC could convene roundtables on this subject.
In addition, we encourage the SEC to approve on a timely basis the recent final rules adopted by the PCAOB requiring certain information to be disclosed by audit firms on an annual and special reporting basis, including as it relates to audit fees and nonaudit fees.

4. Liability: Federal vs. State Court Jurisdiction

We do not take a position at this time on the final matter addressed in ACAP’s addendum, in which ACAP states, “The Committee is considering whether it should recommend that Congress provide federal courts with exclusive jurisdiction over some categories of claims, which presently may be brought in state courts against auditors, when such claims are related to audits of public company financial statements.” ACAP continues, “Should Congress take up this recommendation, it should develop a uniform standard of care with the appropriate and necessary levels of investor protection.”

In theory we would concur with striving for consistent enforcement and adjudication of claims on a national level. We appreciate the points made in testimony before the committee that the state court system is not optimal, particularly given that audit firms are regulated and enforced at the federal level. However, we are not in a position at this time to provide a definitive opinion on this matter.