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

Audit • Tax • Advisory

Grant Thornton LLP  
175 W Jackson Boulevard, 20th Floor  
Chicago, IL 60604-2687  
T 312.856.0200  
F 312.565.4719  
[www.GrantThornton.com](http://www.GrantThornton.com)

**Draft Report of the Advisory Committee on the Auditing Profession of May 5, 2008 and Addendum to VI. Firm Structure and Finances of June 3, 2008**

Chairman Levitt and Chairman Nicolaisen:

Grant Thornton LLP and Grant Thornton International Ltd welcome this opportunity to build upon earlier testimony offered to this Advisory Committee on February 4 and June 3, 2008. We continue to support the important mission of the Department of the Treasury's Advisory Committee on the Auditing Profession ("Advisory Committee") and share its goal of ensuring that the auditing profession remains strong, vibrant and committed to quality.

Our public responsibility is an inherent component of our existence and, most important, it is what distinguishes public accounting as a profession. A robust profession dedicated to quality auditing benefits investors, the capital markets and the U.S. economy.

Grant Thornton LLP is the U.S. member firm of the major global public accounting network Grant Thornton International Ltd. Grant Thornton LLP has more than 5,500 personnel in more than 50 offices across the United States. The member firms of Grant Thornton International Ltd are in more than 110 countries, with some 2,400 global partners and 27,000 international firm personnel, including those in the U.S. firm.

The member firms of Grant Thornton International Ltd are united around a global strategy, common goals and a commitment to excellence. Our network meets every measure of a global network established by the International Federation of Accountants. We have the deep capability to conduct financial statement audits of large global companies thanks to our global organization's broad international footprint. Grant Thornton's presence in this market is well-established and growing.

Grant Thornton LLP and Grant Thornton International Ltd have made in recent years and continue to make a series of major investments to raise the U.S. firm's and network's penetration of the large public company audit market, as we are committed to growing our market presence.

We believe that the Advisory Committee's final report should properly and accurately reflect Grant Thornton's position as one of the major global accounting networks and recognize our presence and continuing desire to compete successfully across the spectrum of the public

company audit market. We ask that the Advisory Committee avoid reinforcing outdated and inaccurate notions about the competitive organization of the U.S. accounting firms and the global networks to which they belong, and recognize that capability and reach characterize the modern public company audit marketplace. We ask that the Advisory Committee remain sensitive to this reality as it finalizes the language of its report.

We believe that the Advisory Committee should evaluate its recommendations for relevancy and thoroughness in light of its founding mandate, as voiced by U.S. Department of Treasury Under Secretary for Domestic Finance Robert K. Steel in his welcome and introductory remarks during the Advisory Committee's initial meeting on October 15, 2007: "The Department (has) charged the Committee with developing recommendations *taking into consideration the issues impacting the sustainability of the auditing profession.*" [Emphasis added]

We ask that the Advisory Committee recognize all of the issues that impact the sustainability of the profession, and address the foundation elements of sustainability that have been the subject of testimony and public comment for the past eight months. In reflecting on what has been presented, coupled with our experience leading a major global accounting network, we believe that the profession's sustainability rests on five essential underpinnings. To be sustainable, the profession must be able to:

- **Continue to offer a respected and valuable service**, in an atmosphere in which high quality auditing on a global basis is both encouraged and enabled,
- **Operate in a competitive environment**, in which issuers are able to choose their auditing firms based on their particular needs,
- **Serve global markets in a fair and rational liability environment**, in which wrongdoers are appropriately punished and the markets are not put at risk by the very real potential of catastrophic audit firm liability,
- **Help seed the future of the profession**, by ensuring that the best and brightest – appropriately educated and deeply committed – enter and remain in public company auditing, and
- **Master the challenges of financial market globalization.**

With this in mind, we are pleased to offer our observations about the Advisory Committee's May 5 Draft Report ("Draft Report") and the June 3 Draft Report Addendum ("Addendum") related to firm structure and finances published in the Federal Register on June 12, 2008.

### Human Capital

The May 5 Draft Report does an excellent job of covering and addressing many of the relevant factors that contribute to the sustainability of a capable, committed and diverse public accounting workforce. Anne Lang, Grant Thornton LLP's Chief Human Resources Officer, presented our views in testimony during the June 3 hearing and in response to subsequent follow-up questions from the Advisory Committee. We commend the Advisory Committee on its work in this area. Updating curricula and examinations, increasing the number of Ph.D. faculty, collecting and evaluating educational profile data and studying the future of the structure of higher education for the accounting profession will undoubtedly be useful in helping to anticipate and accommodate the growing need for appropriately educated and deeply committed auditors.

### **Firm Structure and Finances**

We commend the Advisory Committee for evaluating many of the most important issues in this area, and we support working with the profession and government regulators to improve the areas covered by the Advisory Committee's recommendations.

In particular, we offer perspectives on some of the recommendations offered in this section of the Draft Report and the Addendum.

- **Fraud Detection and Prevention Center.** We agree with the proposal to create a national center to pool the collective fraud detection and prevention expertise of the profession, commission new research and promulgate best practices. The creation of such a center will serve the profession, investors and the capital markets by enabling public company auditors to have the most current fraud detection tools available. We note that wide involvement by other market participants is vital to success.
- **Improvements to the Auditor's Report.** We support revisions to the Auditor's Report that would more fully and explicitly explain the auditor's responsibilities with respect to detecting material financial statement fraud and emphasize management's and the audit committee's responsibility for preventing and detecting it.

We believe that the public interest would be best served if the PCAOB, ASB, IAASB and the profession were to work with the preparer community and users to undertake research into what users really need and want in the Auditor's Report. This research should extend beyond the realm of disclosures related to financial fraud responsibility; it would also be useful to understand users' needs in a broader context, including their desire for more information about what the auditor has done in conducting the audit. Numerous commissions and committees over the years have recommended such changes.

Evaluation of these findings should be coupled with a careful analysis of other relevant issues, including: whether expanded disclosures should be made by management, audit committees or auditors in view of the access to information available to management and audit committees; how existing international standards, such as ISA 700, might be changed; whether liability issues would drive the report to become boilerplate; and the legal and regulatory ramifications of such changes. We recognize that other countries, such as those in the EU, use more extensive forms of audit report, but they have significantly different cultures and auditor liability regimes from that operating in the USA. The goal would be to use the results of this collective effort to develop one reporting model to be used globally.

We also ask the Advisory Committee to consider whether issuers should be required to explain their responsibility for preventing and detecting financial statement fraud to users, rather than simply including a statement in the audit report. Doing so would make it clear to users of financial statements the role of management in prevention of financial statement fraud and the auditor's responsibilities with regard to detection.

- **Independent Board Members.** We support enhancing the governance of accounting firms through the inclusion of external board members. Such change may be one way to strengthen our ability to serve market participants and reinforce independence.

However, we suggest that the Advisory Committee explicitly acknowledge the regulatory, legal and policy obstacles that currently impede the addition of voting members from outside a firm. Such obstacles include: requirements related to protecting client confidentiality; the application of independence rules to outside board members; state-based rules regarding the acceptable structure of an accounting firm, including percentage of CPA ownership; and long-standing partnership agreements that require board members to be partners or principals, as well as other related restrictions. The current draft language may lead readers to conclude that such action is immediately possible, which is an incorrect assumption. We ask that the Advisory Committee consider calling for the PCAOB, SEC and state regulators to explore and address these obstacles as part of its recommendation.

- Engagement Partner Signature on Audit Report / Disclosing Senior Engagement Partners in Company Proxy Statements. In the Addendum, the Advisory Committee states that it “is considering recommending that the PCAOB revise its auditor’s report standard to mandate the engagement partner’s signature on the auditor’s report.” In the Draft Report, the Advisory Committee recommends disclosing senior engagement partners in company proxy statements. We recognize the rationale for these recommendations, but believe that they will have no impact on audit quality and will result in unintended consequences that are detrimental to the profession’s sustainability.
  - Naming senior engagement partners and requiring the signature of the engagement partner on the audit report may cause confusion among users, who may conclude that the entire firm is not behind the report. It may also incorrectly signal to users and the markets that the practice of public company auditing is an individual effort, rather than a multi-faceted collective enterprise involving many experts in many disciplines, with numerous institutional checks and controls.
  - Requiring an engagement partner signature or disclosing senior engagement partners on the proxy statements could be detrimental to the human capital needs of the profession, as prospective engagement partners may be unwilling to accept the real or perceived added risk. Even though other jurisdictions may require engagement partner signatures, these jurisdictions operate under different auditor liability regimes.
  - Disclosing a partner’s name to the public could also create personal security and privacy issues for that individual.
  - The Advisory Committee’s suggestion that the signing partner should face no additional liability by itself offers little, if any, comfort to signing partners. A safe harbor provision clarifying that no incremental liability for signing partners is intended should accompany any signing requirement.
- Transparency. Grant Thornton LLP supports greater U.S. firm transparency to further enhance the trust and confidence of investors, regulators and audit committees in the quality of public company auditing and the integrity of the firms that perform such audits. We ask the Advisory Committee to re-evaluate the recommendation in its Addendum to reflect the public policy objective of providing audit firm information to the constituencies for which it would be useful.
  - For the public – new information that is relevant to audit quality

- For regulators – new information to help them understand the financial stability of regulated firms
- For audit committees – new information to help them assess audit firm quality, engagement team performance, scope of the audit, audit fees and other related factors important to the hiring or reappointment of audit firms

We believe that Article 40 of the EU 8<sup>th</sup> Company Directive should be the reference point for meaningful transparency reporting. Disclosure of audit firm financial statements would provide little, if any, value to the public who have audit oversight systems in place to monitor audit quality. There is no evidence to suggest that audited financial statements would improve audit quality or the sustainability of the auditing profession.

The proposed public financial statement requirement may also exacerbate the current concentration in the audit market, one of the Advisory Committee's major concerns. Smaller audit firms affected by the proposed requirement may believe that revealing full financial information would compromise a particular competitive advantage or undermine their partners' privacy or security. Such firms may choose to opt out of the public company auditing market, especially in cases in which public company auditing contributes a small percentage of the firm's revenues. Equally troubling, audit committees may begin to choose firms with the greatest resources rather than those that offer the best fit – further cementing concentration.

It is critical that any final recommendations from the Advisory Committee recognize that public disclosure of U.S. firm financial statements, without a legal or regulatory regime consistent with that in other countries where such disclosure is required, would be damaging to the profession's sustainability, as such disclosures would likely open up new avenues of liability risk and have the potential to engender damage claims based on a firm's financial situation rather than actual damages.

- Catastrophic Liability Risk. The unlimited, uninsured and potentially catastrophic top-side liability risk facing firms in the U.S. threatens the long-term sustainability of private sector auditing of public companies. It is a concern not only for the U.S., but for the global economy. Data and testimony submitted to this Advisory Committee supports recognition of the serious risks facing the auditing profession. We ask the Advisory Committee to recognize the catastrophic risk faced by the auditing profession in its final report.

We also suggest that the Advisory Committee seriously consider recommending measures by the SEC to improve clarity and predictability about the scope and breadth of liability under Section 10(b) of the Securities Exchange Act of 1934 and Securities and Exchange Commission Rule 10b-5; measures that would allow for reasonable apportionment of liability based on market realities and litigation process improvements that would enable defendants to thoroughly litigate legitimate defenses. Additional detail about these proposals was included in Ed Nusbaum's February 4 testimony.

We also note that earlier this month the European Commission issued a recommendation concerning the limitation of auditors' civil liability, asking Member States to decide on the appropriate method for limiting liability based on a set of key principles to ensure that any limitation is fair to investors, auditors, audited companies

and other stakeholders. Its main purpose was to encourage the growth of alternative audit firms in a competitive market, responding to the increasing trend of litigation and lack of sufficient insurance coverage in this sector. Internal Market and Services Commissioner Charlie McCreevy said: “After in-depth research and extensive consultation, we have concluded that unlimited liability combined with insufficient insurance cover is no longer tenable. It is a potentially huge problem for our capital markets and for auditors working on an international scale. The current conditions are not only preventing the entry of new players in the international audit market, but are also threatening existing firms. In a context of high concentration and limited choice of audit firms, this situation could lead to damaging consequences for European capital markets.”

### **Concentration and Competition**

The Advisory Committee, the profession, policy-makers and others are challenged to ensure that competition continues to define the structure of the financial markets and the market for audit services. In the audit market for the *Fortune 1000* companies, misinformed but persistent notions about audit firms’ and audit networks’ capabilities, lack of public recognition by government and business leaders, and lingering misperceptions that quality is linked solely to size fuel the concentration that exists today. In this area, we offer the following observations:

- **Disclosure of Third Party Agreements Limiting Choice.** Requiring disclosure by public companies in their annual reports and proxy statements of any provisions in agreements with third parties that limit auditor choice is a very significant step forward. Such public disclosure will create incentives for audit committees to optimize their auditor choice and help clarify that size alone is not the best criterion when selecting an auditor.

We also suggest that institutional investors, other finance providers and intermediaries be required to state their policies on auditor appointments, both generally and in conjunction with specific transactions. Disclosure by public companies of third party agreements limiting auditor choice is important and necessary, but our experience is that such disclosure is not sufficient to ensure adequate competition. By the time a public company discloses such limitations, the choice of auditor has been made. Audit firms that are not on the “approved” list have no prior notice of such restrictions, discover such restrictions months after the fact and, most important, have no meaningful opportunity to compete for the audit. To address the competitive disadvantage created by such restrictions on auditor choice, we ask the Advisory Committee to recommend public disclosure of these agreements before they serve to restrict competition.

- **Indicators of Audit Quality.** We support the goal of assessing audit quality, while sharing the Advisory Committee’s recognition of the challenges in developing and monitoring such indicators of audit quality. Given these challenges, it would be helpful for the Advisory Committee to articulate the overarching objectives of quality indicators to inform the PCAOB-led feasibility study. Analysis of the resulting indicators should take into consideration how measures might differ based on a firm’s partnership model, size, breadth of audit practice and audit specialty, among other factors. We note that, with respect to monitoring audit quality, Grant Thornton International Ltd supports, and our internal procedures are benchmarked to, International Standard on Quality Control 1 (ISQC 1). We also note that audit quality

cannot be measured solely with quantitative data, and urge the PCAOB to consider non-numeric factors in its work. We also request that the PCAOB be encouraged to leverage and use, as appropriate, the work undertaken by other respected independent organizations around the world.

Grant Thornton deeply appreciates your focused examination of the important issues related to the auditing profession that affect investors, the U.S. capital markets, financial reporting and the sustainability of the profession itself. Please do not hesitate to contact us if you have any additional questions about the content of this letter or seek more information.

Sincerely,



**David McDonnell**  
Chief Executive Officer  
Grant Thornton International Ltd



**Edward E. Nusbaum**  
Chief Executive Officer, Grant Thornton LLP  
Chairman, Grant Thornton International Ltd Board  
of Governors