

June 5, 2008

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COMMENTS BY  
THE HONORABLE RODERICK M. HILLS  
REGARDING DRAFT REPORT OF THE  
ADVISORY COMMITTEE ON THE AUDITING PROFESSION

In establishing the Advisory Committee a year ago, Treasury Secretary Paulson observed that a “vibrant auditing profession” was critical to the long-term well being of the U.S. capital markets and also that the profession faced legitimate questions about its long-term sustainability. He signaled his hope that the Committee’s work would help allay these concerns by identifying actions that would help strengthen and sustain the auditing profession. The Committee recently responded with a draft report that includes a number of valuable recommendations.

I write, however, to express my considerable concern that the draft report does not fully appreciate how severe the risk is that outsized liability claims can drive another one of the larger audit firms out of business and does not offer proposals to mitigate that risk.

I write also to request that the Committee consider the consensus recommendations that are made in two reports issued by the American Assembly of Columbia University:

- *The Future of the Accounting Profession (2003): and*
- *The Future of the Accounting Profession: Auditor Concentration (2005).*

Electronic copies of the reports are attached.

Along with Russell Palmer, former Dean Wharton School and CEO of Touche Ross & Co, and Michael Cook, former CEO of Deloitte & Touche USA, I was privileged to lead the discussions of the more than 70 distinguished professionals that attended one or both of the sessions that led to the consensus recommendations contained in these reports. You will see from the list of attendees that they are recognized leaders from the worlds of finance, accounting, law, academia, investment banking and include a substantial number of current and former regulatory officials.

Our report made these points:

- In the 2005 report: “Participants widely agreed that the threat of liability and consequences of losing another Big 4 firm are more serious than most people realize... .”
- Also in the 2005 report: “The current pattern of litigation involves huge claims... the extent of which prevents firms from even bringing their cases to trial, forcing them to settle to avoid potentially debilitating damages. Jury trials pose a significant hurdle for defendants, as the complex, technical issues that fraud and other cases often involve are difficult to explain to those with limited financial background, especially in the face of unrelenting publicity and sympathetic plaintiffs.”

We certainly noted that private litigation is an effective and necessary tool for policing the conduct of the private business sector but we expressed the strong view that the balance had tipped in an unhealthy way for the auditing profession. The Assembly participants expressed the view that the size of claims had grown so large that even a single losing judgment could destroy a firm, and that the danger was further exacerbated because of the unavailability of insurance to cover the liability risk.

Given the potentially catastrophic risk that one or more of the remaining Big 4 firms can be destroyed by litigation I urge the Committee to set forth a greater sense of urgency in its report.

Recommendation 2 in the report’s section on “Concentration and Competition” *does* propose a PCAOB monitoring system as well as a method for rehabilitating troubled firms. These proposals for monitoring and firm rehabilitation [Recommendations VII. 2(a) and 2(b)] certainly merit consideration, but the recommendations rest largely on the notion that liability risk can be internally controlled by a strong governance and careful attention to audit quality.

I believe that stronger protection is needed. Our 2005 report recommends that that a combination of PCAOB monitoring and SEC oversight be developed to provide “safe harbor” protection from civil litigation until and unless the SEC decides to act.

The Committee has produced an insightful report with a number of valuable recommendations. I am encouraged, for example, by the recent Addendum to the Section VI of the Firm Finances and Structure section of the draft report that raises the possibility of exclusive federal court jurisdiction over claims related to public company audits. Considering the extensive federal regulation over the audit firms and the audit process a parallel process of federal court jurisdiction would be

appropriate and could reduce redundant lawsuits arising from the same audit engagement.

Still, I respectfully urge the Committee to take a closer look at the liability issue. The Committee has the opportunity to move us toward a solution with an emphatic and explicit statement of the problem. If the Committee makes plain that the liability problem is real, significant, and imminent, and needs an early solution it will create an opportunity to advance public discussion of potential solutions.

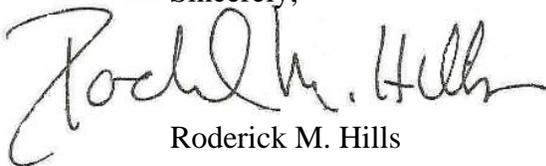
Finally, I wish to make a comment relevant to the discussion of the Auditor's Report in the recent Addendum. In the 2003 American Assembly report we concluded:

***“New attestation standards are needed. The current standard is appropriate for some but not all transactions. Going forward auditors should be prepared to offer and investors prepared to accept more limited attestations when the facts require them.”***

Please review our discussion of this point that begins on page 25 of our 2003 report. The participants who support this recommendation include three former SEC Chairmen, three former General Counsels of the SEC, six of our most respected stock analysts (both buy and sell side) and seven distinguished professors who have long been concerned about the state of our accounting profession.

Thank you for your consideration of these comments.

Sincerely,



Roderick M. Hills