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Phoebe W Brown, Secretary
Public Company Accounting Oversight Board.
1666K St. NW
Washington, DC 20006

RE: BOARD RELEASE 2022-001
Proposal to Establish an Investors Advisory Group (IAG)
and a Standards and Emerging Issues Advisory Group (SEIAG)

Dear Ms. Brown,

I submit this letter of comment in response to the PCAOB's invitation to comment on the Board's January 31, 2022 Proposal to establish an Investor's Advisory Group (IAG) and a Standards and Emerging Issues Advisory Group (SEIAG) early in 2022.

I was a Member of the recently discontinued Standards Advisory Committee (SAG) for two terms, from 2011 to 2017. Other positions I have held that bear upon public company financial reporting include:

- Membership on the ADVISORY COMMITTEE ON THE AUDIT PROFESSION, (ACAP) convened by the Department of the Treasury from 2006 to 2008
- Initial Chair of the Leadership Board of the CENTER FOR CAPITAL MARKETS COMPETITIVENESS (CCMC) from 2007-2011 and currently Chair Emeritus
- Global General Counsel of Touch Ross and of Deloitte and Touche from 1974 to 2002
- Global Chief Strategy Officer for Swiss Reinsurance (Zurich) from 2002 to 2010

The PCAOB Press Release of January 31 declares that formation of the proposed Advisory Groups will "...build upon the success of the PCAOB'S past advisory groups." But I suggest that "successful" is not the appropriate term for the rubble of Board-Advisory processes of the past. Much of that history will be useful, but as guidance for change rather than continuity. I urge the Board to reconsider and re-propose an advisory function better suited to the needs of capital market stability and the public interest.

THE RELEVANT HISTORY OF EVENTS

The PCAOB was created by the Sarbanes-Oxley Act in 2002, "...in order to protect the interests of investors and further the public interest in the preparation of informative, accurate and independent audit reports". (SOX Section 101.(a)). SOX was a major event in the operation of the capital markets. One of the primary concerns at the time was the recognized difficulty of replacing 150 years of audit profession self-regulation with the world's first strong government audit regulator. Congress included several features in the Act to ameliorate the potential for painful disruptions of commerce and the capital markets. One of those was to enable and encourage the PCAOB to establish from the outset a Strategic Advisory Board to assure an appropriate influence from the history of auditing to the benefit of future public interest.

SOX set the new Board's mission carefully: "...In order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports." SOX gave the Board the authority and encouragement to establish a Strategic Advisory Committee designed to facilitate a smooth transition for the audit profession to external regulation. T

The Board established the SAG in its first wave of actions by the issuance of Release [2003-009](#) and Rule 3700. The Board noted: "Commentators suggested that it might be appropriate to establish more than one advisory group since expertise is likely to be required in more than one specialized area. The Board is aware that it may need advice in one or more specialized area. (sic) However, the Board has determined to form only one standing advisory group (the SAG). This group, however, may, at the Board's discretion, form specialized sub-groups as needed." (Release [2003-009](#), Appendix 2, page A(2) (vii)).

The determination to place one central advisory process under a single umbrella was significant, and at the time was disappointing to many investor representatives. It is equally significant that the Board saw the need to mandate that SAG members must "...act in the public interest in his or her individual capacity and not as a representative of any constituency." (Release [2003-009](#), Section B(6)(c)).

However, these initial arrangements gave way to the Board's establishment, in 2009, of the Investor Advisory Committee, on quite different footing than was in place for the SAG. IAG was launched with a Charter. It was given its own leadership, a right to set its own agenda, the right to produce its own research and proposals and the freedom to meet in Executive Session. These are the self-evident requirements for an advisory body to function as a body, to take votes and make decisions, to advise on the matters and in the terms that it deems necessary to add the value to the Board's deliberations. None of those functional requirements had been conferred on the SAG or

permitted in SAG procedures. Curiously, the IAG came into existence without public notice, without notice or an opportunity for SAG advice, and conspicuously without modification of the Release or the Rule. The IAG was never conformed to the PCAOB's constitutional documents.

When I became a SAG member two years later, a palpable air of tension and conflict suffused the meetings and caused aggravation over meeting agendas and the large volume of Staff created, highly detailed materials that were the sole discussion documents allowed for SAG consideration. The cause of difficulty lay in the restraints imposed by the Board and staff on SAG activity.

Several SAG members had been appointed to the IAG at its formation. The IAG exercised its structural advantages, appeared to have close rapport with the Board and had their efforts facilitated by Board member Harris as its chief cheerleader. But the SAG had no Charter. Its Chair was the Board's Chief Auditor, who kept tight control over agenda planning and management as well as all SAG meeting materials. As a result, non-IAG members could do little more than attend and comment individually on Proposed Auditing Standards that had been pre-vetted by the Investors as a group. On several occasions it became clear that a solid majority of SAG members did not agree with Staff proposals. But voting on those issues was barred, and the Staff-prepared Minutes contained no reflection of the opposing views. Subsequent protests about the minutes also vaporized.

The conditions were, in the view of myself and others, unsustainable. I assumed that this was not what the Board had intended, and sought quiet discussion with the Board Chair. He declined, but assigned the Chief Auditor to discourage my efforts. When all attempts at dialogue had failed, I asked for the contact list of SAG members, which had never been provided. I was told by the Board's General Counsel that the Board had no authority to release that information, at least not to the SAG.

When the circumstances engaged the interest of the media, the issues were placed on the November 2016 SAG meeting agenda. The underground rumblings of that unpleasant time soon became part of the 2017 earthquake of change on K Street.

THE ROGUE REPORT

Seismic shifts in the advisory processes had occurred in 2015, but not widely appreciated at the time. In the autumn of that year, the Board issued to SAG members a "Concept Release Concerning Reports on Audited Financial Statements and Related Amendments to PCAOB Standards" This was to be the primary topic at the December SAG meeting. The Concept Release had not been issued for public comment, but it was a major initiative to expand

the auditors role, responsibilities and procedures, subjects that were then receiving attention from other IFIAR member regulators.

On December 1, a few days prior to that meeting, the American Accounting Association published a 64 page document headed "RESPONSE OF A SUBGROUP OF THE PCAOB'S INVESTOR ADVISORY GROUP TO THE PCAOB'S CONCEPT RELEASE..." The document was signed by eleven members of the IAG, acting as co-authors. Each of the co-authors was a widely recognised person employed as pension fund managers, investment advisors, regulators or their advocates. To the best of my knowledge, none had significant experience in other aspects of capital market activity and no notable direct investments. The Report's Executive Summary begins: "As members of the PCAOB's Investment Advisory Group, we believe that the current auditors report is deficient as a communications vehicle, and that significant changes to the auditor's report are needed to remediate the deficiencies."

The Report dominated the SAG discussions of the Concept Release, without addressing in any way the status of its authors, without any disclosure or explanation to the non-IAG members of the SAG, and with no explanation of the position of the eight IAG members not identified with the document - were they opposed to the content or unaware of its existence? There was no explanation offered for why the document was published before the SAG meeting. Since its authorship had no apparent organization status, there is no term of easy and accurate reference to the document. I will hereafter refer to it as the Rogue Report.

The position of the Report's authors throughout the SAG discussion (as was true also of the document itself) was heavy emphasis that its content and recommendations were sound because they were based upon the results of a survey that the authors had conducted among the members of the American Accounting Association a few weeks earlier. No survey description or methodology was provided at that time, though it appears to have been filed with the Board at a later date. But readers of the published version, and those of us associated with it in the SAG discussion were urged to accept its findings as a self-evident showing of the will of the investment community. It was reasonable after all to assume that the survey had been professionally conducted and was statistically sound. Alas, that was not the case. The following information is taken from the PCAOB's files.

- All aspects of the survey were carried out by the eleven signatories, without third party support or verification.
- The survey form requests responses from "at least one governance professional and at least one portfolio manager or senior analyst from your organization." No need apparently for any expertise other than

marketing and governance.

- Assurance is given that the survey will take no more than 10-15 minutes to complete. Responses take the form of scaled agreement or disagreement with one sentence long declarations. Explanations were permitted but not required.
- The survey consists of 9 such statements, with 1 of 5 choices for response. It was described as conforming to a statistical methodology which Wikipedia declares to be unsuitable for this kind of survey.
- Three of the nine statements deal with independence, one with AQIs and one with internal controls. Four are questions that ask if the respondent places confidence in aspects of the current form of auditor's report, and are to be answered YES or NO.
- The number of responses is not disclosed.

The simple content and weak disciplines of the survey preclude reasonable reliance on its results. That explains the absence of a disclosed methodology, but that did not inhibit the authors from ascribing great meaning and significance to the responses. The Report expresses strong and lengthy views regarding:

- Fair value measurements
- The auditing of management's estimates and judgements
- The auditing of unusual and non-recurring transactions.
- Reliance on the work of other auditors
- The need for revised and extended audit procedures and auditor responsibilities
- New mandated disclosures in the audit report and in the associated financial statements
- Protocols for correcting material misstatements in prior year financial statements

It would not have been possible to extract the comments and recommendations in the Rogue Report from the survey its authors had conducted. Nor could the total of responses to the survey have established any substantive statements about the business of the PCAOB, much less offering any credible thought or information. Yet these topics have formed the Board's Standard Setting Agenda since the end of 2015. And the substance of Standard Setting decisions by the Board since then can be easily traced to the roots planted in the Rogue Report.

THE CONCERNS

THE CONCERNS

These matters give rise to a multitude of concerns. Many of them involve manipulation of process and procedures that should be of concern to all who view public company financial reporting as the backbone of our unique capital market strengths. But it should also be distressing to recognise the financial burdens and market disorders caused by the one-handed approach taken in SOX section 404 that mandates the auditing of internal controls - an occasion of controversy and disorder that would most likely not have occurred had the implementation protocols been designed with two handed collaboration.

The risk of similar harm arising from future repetitions of one-handed regulatory influence is high. The Conclusion of the Rogue Report asserts that "Requiring the auditors to discuss risks, estimates and judgements accounting policies and unusual transactions **SHOULD STRENGTHEN THE AUDITOR'S POSITION IN NEGOTIATING WITH MANAGEMENT.**" (Emphasis added) I doubt that its authors actually meant to endorse actual negotiations by auditors in management's duty to prepare and present the issuer's financial statements. I assume the comment was an unfortunate metaphor. But at a minimum, this represents a muddled mindset, one that is frequently heard today in relation to ESG measurement and reporting. ESG issues lead a long list of policy matters pursued today as social evangelism. Whatever the merits of these movements, the regulators, the markets and the public interest require the attention of two-handed advice to determine soundly what influence they should have, if any, on public company financial reporting and authentication.

A similar but more significant risk lies in the Rogue Report's presumptions about the place of investors in the capital market architecture. "To summarize, the substantial majority of investors who participated in the IAG survey would derive great value from receiving the same communications from the auditor regarding audit and financial statement risk which the auditor provides **TO THE INVESTOR REPRESENTATIVES - THE MEMBERS OF THE ISSUERS AUDIT COMMITTEE.**" (Report, para. 17, emphasis added.) The authors treat this as a fundamental perspective about the financial reporting process - that an issuer's audit committee is the alter ego of investor interests. They seem to believe that an audit committee has no other constituency, that its members are not also directors of the company, that it is beholden to the instructions of investor voices. In effect, the position is roughly equivalent to declaring that there is a direct line of legally mandated responsibilities of auditors to investors, and that the PCAOB has obligations only to the investor community. In fact, that perspective was manifested constantly in SAG discussions in the form of both subtle and overt claims that investor requests did not need to be justified, only articulated, to compel compliance. Much devilment has come

from this assumption, and more will follow if the terms of advisory bodies to the PCAOB are adopted.

Once again, ESG issues illustrate the difficulty. The magnitude of economic, industrial and social change sought by advocates of new financial disclosures is too great to be decided on a tilted playing field of influences. The Rogue Report espouses a new conceptual framework for the US economy - a shift from the scientific disciplines of entrepreneurial capitalism to the artistic flexibility of progressive capitalism. Movement in this direction seems to be on the wind in the US these days, seeking to be accepted as principles that cannot be denied and should not be debated. The PCAOB should not mindlessly facilitate such change through modification of public company financial reporting.

It is unfortunate that these concerns arise in such a toxic political atmosphere. The misfortune is compounded by the evolution of "investor" representation in recent decades. The securities laws were adopted when the model of capital market behavior was based on direct investment by the beneficial owners of equities. Today more than 70% of US public equities are in the hands of vast pools of pension, benefit, savings and similar aggregated funds. Investment pools like Softbank lift the proportion of intermediated ownership to more than 80%. The managers of those collective funds have assumed that it is their right to influence and control the use of shareholder voting rights. Yet they do precious little to determine and act on the preferences and objectives of the beneficial owners. Further intermediation by a cartel of lightly regulated investment advisory firms compounds the disconnection.

Intermediation problems now extend to the rising tide of index funds. The difficulty was noted just this week by Charles Munger of Berkshire Hathaway: "We have a new bunch of emperors, and they're the people who vote the shares in the index funds. I think the world of Larry Fink, but I'm not sure I want him to be my emperor." (WSJ editorial of February 25, 2022) The Journal adds: "But lately these so-called passive index providers have themselves become activists, and not in a good way. Rather than push companies to pursue higher returns, they're trying to impose their political agenda on corporate America." (ibid)

RECOMMENDATIONS

Auditing is the essential oxygen of shared confidence in the soundness of financial information for interested parties who operate at arms length from each other - buyer and seller, management and owner, regulated entity and its regulators. Without the lubricant of shared information and confidence,

range of Board responsibilities as the IAG deems necessary.

The Board proposes quite a different mission for the new body. The SEIAG is "...to advise the PCAOB on existing standards, proposed standards, and, IF REQUESTED BY THE PCAOB BOARD, ON MATTERS OTHER THAN STANDARDS THAT ARE OF SIGNIFICANCE TO THE PCAOB, INCLUDING EMERGING AUDIT ISSUES." (emphasis added)

The subtle but powerful messages here seem quite clear. The IAG is not just empowered to give priority attention and service to the interests of investors - it is instructed to do so. And the scope of legitimate IAG attention is as broad as that of the Board. By contrast, the new SEIAG is limited to dealing with the Board's proposed standards, unless specifically requested by the Board to look upon something else. This body, which bears the name "Emerging Issues" may not address any such thing without specific permission. Yet the supposedly specialized IAG has free right to roam through the fields of emerging issues at will.

The Board proposal contains other curious tilting devices, explicable only in the perspectives of the Rogue Report.

- To enhance coordination between the two advisory groups, it is proposed that one or more members (without maximum limit) of the IAG will also be given full membership status on the SEIAG. One might expect a reciprocal provision for SEIAG crossover membership to the IAS. One would be disappointed; The SEIAG Framework warns that the group will receive crossover membership, but have none in return. This does not appear to be a drafting error.
- Co-chairs will lead the IAG. One will be a member of the IAG and the other will be either a Board or Staff member. The Chief Auditor will be the SEIAG Chair.
- IAG membership will require "relevant expertise and/or experience in investing in public companies (e.g. institutional investors; retail investors; pension fund managers; investor advocates; academics focussing on investment issues; or other relevant expertise)." In other words, all investment perspectives except direct investors with skin in the game and financial performance in mind.
- Agenda setting authority for the IAG rests with the co-chairs. For the SEIAG, agendas must be approved by the Board. These are tedious matters, but they are also opportunities for outcome management.

Release [2022-001](#) will not provide the PCAOB with expertise and advice for the full scope of its statutory mission. It will not provide advice that integrates

the conflicting objectives of stakeholders with inevitably conflicting objectives. It won't create conditions favorable to getting value from the separate inputs of issuers and investors. It won't preserve or enhance the quality or value of auditing or assurance. And most fundamentally, it won't produce a source of advice that can be sustained over time and refined by experience. Instead it will continue and enlarge the functional chaos of advisory input after 2009.

I RECOMMEND that Release [2022-001](#) be withdrawn and replaced, after due consideration, by a new Release based on:

- Establishment of a single Strategic Advisory Group, empowered to create an investors subgroup which reports to and is part of the SAG.
- Enable the SAG to function as a body with its own leadership, agenda influence and a reporting relationship to the Board as well as the Staff.
- Engage the SAG sufficiently early in the standard setting process to assure that its views could influence the product if the Board wishes.

Respectfully,


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