February 28, 2022

Chair Erica Y. Williams
Mr. Duane M. DesParte
Ms. Christina Ho
Ms. Kara M. Stein
Mr. Anthony C. Thompson

Public Company Accounting Oversight Board
1666 K Street NW
Suite 300
Washington, DC 20006-2803

Re: Reform of the Public Company Accounting Oversight Board (PCAOB)

Dear Chair Williams and PCAOB members:

Congratulations to each of you on your appointments to serve on the PCAOB. We applaud your willingness to serve and hope for your success in protecting investors.

We, the undersigned former members of the Public Company Accounting Oversight Board (PCAOB or Board) Investor Advisory Group (IAG) and Standing Advisory Group (SAG), write in our individual capacities to (1) respond to your request for comment regarding the proposed structure of the new IAG and Standards and Emerging Issues Advisory Group (SEIAG) and to (2) share our perspectives on urgent matters that should be addressed by the PCAOB. It is important to emphasize that staying the course, is not an acceptable strategy but one that would do significant damage to trust and confidence in the agency. Prior to your appointments, we believed that the PCAOB was falling short of carrying out its responsibilities as set forth by Congress in the Sarbanes-Oxley Act of 2002 (SOX).[1] Given our experiences with the PCAOB and your recent appointments, we would like to highlight areas requiring attention.

In SOX, Congress stated the role and responsibility of the PCAOB is "… to oversee the audit of public companies that are subject to the securities laws, and related matters, in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports for companies the securities of which are sold to, and held by and for, public investors."[2] Interestingly, the PCAOB, in certain years, has moved to reduce its own budget including for its critical inspections function. Given all that needs to be done, we believe that the PCAOB needs to seek adequate funding. The Board also needs to adopt and follow a meaningful Strategic Plan. In 2018, we were given an opportunity to comment on the Strategic Plan. Curiously, the plan mentioned investor protection only once, in stating the PCAOB's mission. It also mentioned enforcement only once, weakened inspection requirements and deemphasized diversity when compared to the PCAOB's prior strategic plan. Unfortunately, the PCAOB has failed to live up to even its less ambitious strategic plan. With that frame of reference, we (1) make the following comments on the proposed advisory group structures and (2) the top priority

[1] The Sarbanes-Oxley Act of 2002 (Pub.L. 107-204, 116 Stat.745, enacted July 30, 2002).
[2] Id. at Sec. 101.

recommendations for the PCAOB's Operational Priorities; Standard Setting Activities; Inspection Activities and Enforcement Activities:

Comments on the Structures Proposed for the IAG and SEIAG

We believe that consultation with the advisory groups makes a significant contribution to the work product of the PCAOB. We urge the Board members to be more active participants during the meetings, asking questions, responding to advisory member comments, and challenging ideas in a manner that can enhance the overall discussion and meetings.

The SAG in the past has provided useful input on emerging issues. In addition, investors have also highlighted emerging issues on a timely basis, such as the lack of inspections of auditors of Chinese domiciled SEC registrants. In addition to the SEIAG, we also recommend the Board seek input on emerging issues from the IAG.

The role and purpose of the IAG is well stated in the proposed structure. We believe the role and purpose of the SEIAG should also reference to the mission of the PCAOB to protect investors. Members of the advisory groups devote considerable time preparing materials or themselves for the meetings. However, in the past, in particular the SAG, the groups became so large and unwieldy that there was not sufficient time available for each participant to fully participate. As a result, we agree that a reduction in the number of SAG members to 24, given the diversity of that group, is appropriate. We also believe it may be more efficient if the IAG was no larger than 15.

The Board should establish and make transparent, the criteria it uses for selecting members of both advisory groups. We concur that membership on both groups, should be personal and cannot be delegated to other individuals or to an employer.

The Board has proposed terms for members of two years, with no more than two subsequent renewals. Given the amount of time individual members contribute before and during these meetings and interaction with the Board, it may be more advisable to have three-year terms with a one term renewal.

In the past, the PCAOB has chosen to let the auditing profession select members of the SAG. We strongly urge the Board to discontinue this practice. In addition, we do not believe any entity or organization should be given a "permanent" type seat at the table. We believe the six-year limit on terms without a "time out" period in between terms should be applied to all members.

We agree with the proposed co-leadership structure of a member of the IAG and a member of the PCAOB or its staff. We also agree with the proposed structure for the SEIAG chair being the Chief Auditor. If a member of the SEIAG is added as a co-chair, it necessitates resolving the question of whether it is appropriate to name a co-chair from the auditing firms seated at the table. Two public meetings a year should be sufficient. If the advisory group or PCAOB members determine that the number of meetings should be adjusted, then the PCAOB should adjust the number accordingly. We strongly support the PCAOB making the agenda, transcript of the meeting discussions, and presentation materials used in advisory group meetings public. We do not support making break-out sessions private. Typically, private meetings are used by government standard setters for purposes when legal or litigation matters are involved. Since neither the SEIAG nor IAG are typically involved with such issues, there is simply not a reason for making such discussions confidential. In the last meeting the PCAOB had with the IAG, confidential breakout sessions were held for the very first time. Yet there was nothing confidential with respect to the topics or discussions thereof during those meetings.

In the past, the PCAOB member charged with responsibility for the IAG would solicit input from the IAG members for the highest priority topics. The PCAOB member would reach out to IAG members to get input on topics the members submitted for the agenda, and there were also discussions of these topics among the IAG members themselves. In addition, IAG members provided input on which subgroup working on a topic they would like to serve on. The PCAOB member would then put together a proposed agenda that was circulated to individual members after which it would be finalized. This process worked well and contributed to robust and insightful discussions during the public meetings of the IAG.

We believe it is appropriate to have representatives from the SEC, National Association of State Boards of Accountancy (NASBA), Financial Accounting Standards Board (FASB) and the International Auditing and Assurance Standard Board (IAASB) in attendance. Depending on the agenda of the meetings, it may also be appropriate to invite the Public Interest Oversight Board (PIOB) which is the global independent oversight body that seeks to improve the quality and public interest focus of the international audit and assurance, and ethics standards formulated by the International Standard Setting Boards. The IAG and SEIAG agenda setting should take into consideration topics important to the members of the IAG as well as those which Board members seek IAG and SEIAG input on. There should not be an ability to prevent topics being placed on the agenda that may be unpopular with the auditing profession.

Operational Priorities

Budget and Staffing

As we have previously stated to the SEC, the unusual terminations of the PCAOB's senior staff in recent years, without any public disclosure as to the reasons for this action, were alarming. Equally alarming were the budget cuts previously discussed.

It has been noted by a former member of the PCAOB that twenty years after the formation of the PCAOB, the audits of some of the S&P 500 companies have still not been inspected. As a result, we believe the PCAOB should provide much greater transparency with respect to which audits of public companies are selected.

One of the top priorities of the PCAOB should be to establish a new strategic plan that is supported by the necessary budget. That plan and budget should ensure the Board is able to effectively carry out its legislated mandate to protect investors through high quality audits.

To carry out its strategic plan and accomplish its objectives and goals in a timely manner, the Board should ensure it has staff that fully understand, appreciate, and are committed to the mission of the agency.

Enhance Transparency of Board Operations

The PCAOB needs to greatly enhance the transparency of the operations of the Board. For example, in the past it has failed to:

- Hold regular public meetings.
- Hold public meetings with advisory groups.
- Maintain publicly available records of meetings PCAOB members have with external parties, consistent with the records required of the SEC.
- Solicit public comment on agenda topics.
- Enhance transparency of the PCAOB inspection reports.
- Make bylaws, operating rules, policies and procedures publicly available on its website.
- Consider benefits that standards provide to investors.

There is nothing in SOX that prevents the PCAOB from taking action to bring transparency to the operations of the Board with respect to the above items. The Board should establish written policies and procedures addressing the above deficiencies and making those documents publicly available on its website. Given the Board was established to improve the quality of audits, which enhance the transparency of disclosures by public companies, the Board itself should operate transparently.

We applaud the PCAOB members for taking measures to reestablish its advisory boards. This is a positive step. We hope we will see more steps in the right direction. In that regard, we believe the Board should ensure investors have a voice on advisory groups and have the ability to participate in structuring meetings and setting agendas.

Transparent Rule Making with Public Comment

The PCAOB relaxed the independence rules for auditors at the end of 2020 without soliciting public comments from investors and considering the benefits for investors. This was disappointing given the numerous instances of lack of compliance with auditor independence rules cited by the Board in its various reports. We recommend the PCAOB amend its policies to require that when the PCAOB undertakes to develop new, or revise its existing rules, it do so in a transparent fashion and solicit public comment.

Investor Advocate

Since its inception, only one member of the PCAOB has had experience as an investment advisor, manager, or analyst using financial statements. As a result, we recommend the PCAOB establish an investor advocate position within the agency, as Congress created at the SEC. The position should be staffed by someone who has experience in a position in which they made capital allocation decisions using financial statements and disclosures necessary for making investment decisions.

Establish Objective Policy for Measuring Project Progress and Accountability

During the past twenty years, the PCAOB has added projects to its agenda which were not completed. Other projects have taken extended periods of time. As a result, after two decades, the Board's progress has been slow and accountability lacking. Too many standards remain "interim" standards and some of those, such as for quality control, are outdated. Few enforcement cases have been taken and only minimalistic penalties assessed despite the powers granted the Board in SOX. As a result, the Board should establish a transparent mechanism that:

- Establishes project timetable, deadlines, and budget at the commencement of a project;
- Periodically, but no less than annually, updates the timetables, deadlines and budget;
- Measures the progress on the project compared to the approved timetable.
- Establish a mechanism for measuring progress versus what was budgeted for, and report on that progress in the annual report.

It would also be useful if the Board reported on actions it takes, or declines to take with reasons specified, on recommendations from the IAG or SEIAG, or on petitions for new standards it receives from the public and investors.

Establish Whistle Blower Policies and Procedures

The Board has found itself in disputes, including with prior board members and employees, some of which reflect on the integrity and transparency of the Board. We recommend that the PCAOB establish a whistle blower program, consistent with what SOX and the Dodd-Frank Wall Street Reform and Consumer Protection Act created for public companies and the SEC.

Standard Setting Activities

Interim Standards

The PCAOB was established in 2002, due in part to the failure of the auditing profession to protect investors by establishing high quality auditing standards. One of the PCAOB's initial actions was to accept, on an "interim basis," the then existing auditing standards written by the profession and its Auditing Standards Board (ASB). Unfortunately, In the past twenty years, the PCAOB has failed to update and modify as needed, approximately half or more of these interim standards to meet the expectations of investors.[3] We urge the PCAOB undertake a project to review and revise these remaining interim standards in a timely manner. If that will require additional resources and budgetary needs, we urge the SEC to approve an amendment to the PCAOB's budget.

Recommendations of the U.S. Treasury Advisory Committee on the Auditing Profession (ACAP)

In 2007, the U.S. Secretary of the Treasury appointed a blue-ribbon committee, comprised of members of the auditing profession, corporate boards and finance executives, investors, and former

[3] The Panel on Audit Effectiveness was established by the Public Oversight Board (POB) and SEC in the fall of 1998, in reaction to the growing number of corporate scandals and "earnings management." In August 2000, the Panel issued its report and recommended changes to the auditing standards that would result in additional forensic procedures designed to improve the skepticism of auditors. The PCAOB/AICPA interim auditing standards have not been amended to reflect that recommendation.

regulators, to study the auditing profession in the United States, and issue a report with recommendations. In October 2008, the ACAP issued a report with several recommendations to the PCAOB, yet the PCAOB has failed to act on many of those recommendations such as:

- Disclosure of audit quality indicators to investors.
- Improving the corporate governance and transparency of the large auditing firms.
- Monitoring sources of catastrophic risk faced by registered audit firms; and
- Creating a mechanism for the preservation and rehabilitation of a troubled firm.[4]

An Auditor's Role Regarding Other Information in SEC Filings, such as an annual report, in addition to Audited Financial Statements

The professional standards which set forth the auditors' obligations and responsibility for such information were initially developed in the 1970's. While there have been updates to the standards, the basic approach used by auditors has not changed. Yet in the intervening years, the capital markets have dramatically changed, with the introduction of non-GAAP disclosures, EDGAR and data tagging, and significant modifications in Management's Discussion and Analysis (MD&A) and disclosures of risks given the significant increase in the complexity of business and the global economy they operate in. In addition, the serious and very real risks faced by all sizes of public companies because of changes in the climate have given rise to a need for enhanced transparency so investors can make informed capital allocation decisions.

Unfortunately, the PCAOB has outdated auditing and attestation standards that fail the needs of investors with respect to establishing trust and confidence in the information being reported. Indeed, it is common to see companies being challenged by regulators and investors alike with respect to non-GAAP numbers and "Green Washing" of climate related disclosures.

As a result, the PCAOB should review, update and revise (1) the existing auditing standards with respect to other information contained in annual reports, (2) its attestation concept standard and (3) develop an attestation standard applicable to an independent auditor providing assurance on ESG reports, as was done in the 1980's for MD&A.

Auditor's Consideration of Noncompliance with Laws and Regulations

The IAG requested the Board focus on auditor's consideration of noncompliance with laws and regulations in the PCAOB's agenda. The IAG made recommendations to the PCAOB calling for significant changes in the existing "interim" PCAOB standard, which was written over two decades ago by the auditing profession. The IAASB has also addressed their applicable standard in recent years making needed changes. It has also been the focus of work by NASBA. It is time that the Board make necessary changes and bring their standards in line with the needs of investors and the public.

[4] The PCAOB does not request and receive the audited financial statements of its registered firms. In addition, the PCAOB is not considered to be a prudential regulator, such as banking regulators, in that it does not establish capital and liquidity requirements for each auditing firm.

Establish Meaningful Quality Controls for Performance, Accountability, and Disclosures regarding Audit Quality

When it commenced operations, the PCAOB adopted "interim" AICPA ASB quality control standards that were last updated by the ASB twenty-five years ago, effective for January 1997. These standards are outdated in many respects due, but not limited to:

- Changes in the business operations and structures of the large international audit firms that audit most public companies.[5]
- The way audits are conducted both in the U.S. and internationally.
- The growing practice of "outsourcing" a portion of the performance and supervision of an audit to staff located in distant locations.
- Advances in technology.
- Changes in auditor independence rules.
- The passage of SOX.

The "interim" standards also fail to consider quality control standards used in other industries that may help improve audit quality. In addition, they lack any meaningful quality disclosures to investors with respect to *both* individual audit quality, and audit quality on a domestic and international firmwide basis. Such disclosures should adequately inform investors prior to their casting annual votes on the appointment of the independent auditor. The lack of such transparent information can affect and negatively impact the decisions made by investors.

We believe the PCAOB should establish quality control standards that reflect the views of the end user of independent audits, the investors. In doing so, we urge the PCAOB to seek public input from investors to develop its own standard, rather than using standards developed by another standard setter. Doing so would be consistent with the purpose and intent of SOX and avoid circumstances that led to the corporate scandals at the turn of the century.

Auditor's Independence

The Board has previously noted its inspections have identified numerous violations of the SEC's and Board's auditor independence rules. If there is a lack of independence on the part of the auditor, the audit lacks credibility, and it is misleading to caption the report as that of an independent auditor. These violations are too often dismissed by the auditor and the audit committees, without any disclosures to investors. This action leaves investors woefully uninformed with respect to such violations and to the basis for determining whether an auditor can remain independent.[6] Unfortunately, the previous PCAOB Board members moved in the exact opposite direction and relaxed auditor's independence rules at the end of 2020 without the Board seeking public comment on its revisions.

[5] As measured by market capitalization.

[6] In 2000, the SEC adopted revisions to its auditor independence rules which in Reg. 210.2-03(d) Quality Controls, a provision is made for a very limited exception whereby an auditor's violation(s) will not negatively impact an audit firms' violations of the auditor independence rules. However, it appears the PCAOB may not be requiring audit firms to comply with all the provisions of that rule.

The profession submitted a white paper to the PCAOB addressing, as we understand it, how the profession believes the PCAOB should address such violations. Unfortunately, this raises a serious concern as to why the PCAOB did not afford investors the same opportunity to provide public comment and input on this important matter it provided the auditing profession. We urge the PCAOB to solicit public comment on the profession's white paper, and how and why auditor violations of the PCAOB and SEC's independence rules are addressed and disclosed to investors. The PCAOB should also enforce the established SEC independence rules.

"Going Concern" and Other Audit Opinions Should Provide Timely Information to Investors

The IAG has previously discussed with the Board, that the audit opinions, including going concern opinions of auditors, have failed to provide useful and timely information to investors. For example, the IAG cited examples of U.S. and major international banks, which required "bailout funding" during the financial crisis, received audit opinions that were identical or substantially the same both before the crisis, as well as during the crisis when they required funding from the government (taxpayers). These opinions failed to inform investors of the pending and significant risks and uncertainties the banks – and their investors – were facing. The IAG also cited the need for substantially enhanced GAAP disclosure standards as well, which unfortunately, the FASB failed to adopt. As a result, we urge the PCAOB to undertake a review of going concern opinions to ensure they provide investors with useful and timely information regarding risks and uncertainties that will likely affect the liquidity, cash flows, and sustainability of public companies. It has also been noted that audit opinions issued in accordance with international auditing standards, often provide much enhanced information to investors with respect to materiality and risks, then do the PCAOB standard.[7] Some have argued it is due in part to better defined definitions in the international standards. The PCAOB should undertake a comparison of the audit opinions, including critical audit matters, issued pursuant to its standards, and those opinions issued pursuant to the IAASB standards. If the IAASB standards result in a higher quality audit opinion for investors, the PCAOB should undertake to modify its standard.

Inspection Activities

Improve Transparency of Inspections Findings

The PCAOB inspections should provide additional useful information regarding the quality of independent audits. However, the PCAOB has provided an unnecessary shield to auditing firms which have not complied with PCAOB auditing and SEC and Board independence standards. This is inconsistent with SOX which states the PCAOB is established "…in order to protect the interests of investors and further the public interest in the preparation of informative, accurate and independent audit reports…"

We believe inspection reports are indeed a significant indicator of audit quality on individual audits as well as firmwide performance and leadership. We urge the PCAOB to undertake to make findings of inspections of individual audits more transparent and timely for investors. SOX Section 104(g) REPORT states the Board shall not make public its negative inspection findings

[7] See for example, the audit opinions issued by KPMG on the 2020 financial statements of Rio Tinto included in its Annual Report and Form 20-F.

with respect to an audit firms *quality controls*, to afford the firm up to one year to correct any deficiencies. However, all too often, the Board has given the audit firms a much longer period, even multiple years, to correct such findings. This raises the question as to why it takes a firm so long, to correct deficiencies in its quality controls?[8] This lack of transparency can be detrimental to investors and the public. Accordingly, we recommend the PCAOB comply with the 12-month period and issue their reports on quality controls in a prompt fashion thereafter.

Enforcement Activities

A 2019 investigation by the Project On Government Oversight (POGO) found:

> The PCAOB…inspection reports have cited 808 instances in which the U.S. Big Four performed audits that were so defective that the audit firms should not have vouched for a company's financial statements, internal controls, or both.
>
> Yet, despite those 808 alleged failures, the audit cop has brought only 18 enforcement cases against the U.S. Big Four or employees of those firms. Those cases involved a total of 21 audits.
>
> If the 808 audits cited as fatally flawed in the inspection reports were as bad as the reports said, it appears that the audit cop could have fined the audit firms more than $1.6 billion—that's billion, with a "b."
>
> Yet, since it began working the beat, the audit cop has fined the U.S. Big Four a total of just $6.5 million, POGO found. That's million, with an "m."
>
> That's less than one half of one percent of the potential fines.[9]

The POGO report indicates the PCAOB has engaged more in "remedial" actions rather than enforcement actions. Yet SOX explicitly gave the PCAOB the power to undertake enforcement actions to protect investors. To date, the POGO findings call into question whether the PCAOB has fully exercised its authority to ensure that audits are of a high quality.

The PCAOB should review its enforcement program and assess whether it is fully complying with its obligations to protect investors by taking all appropriate actions to ensure audits are of a high quality. This includes a review of its staffing for investigations and litigation, the reasons for its lack of enforcement actions, and the necessary investment to ensure a top-notch enforcement program.

[8] This should be considered by the PCAOB when it develops new audit quality control standards, including why changes in quality control take so long to design, implement, and become effective.

[9] How an Agency You Have Never Heard of Is Leaving the Economy at Risk, Project On Government Oversight. David S. Hilzenrath, Nicholas Trevino. December 05, 2019. See: https://www.pogo.org/letter/2021/05/pogo-urges-new-sec-chair-to-reform-the-audit-industry/

Conclusion

We share the above priorities out of concern for the overall effectiveness of the PCAOB in meeting investor needs. In line with its mission, we expect the PCAOB to further the public interest in the preparation of informative, accurate, and independent audit reports. Each of the undersigned recognizes the importance of this work for market transparency and risk reduction. There is considerable heavy lifting ahead to return the PCAOB's focus to its primary mission of investor protection. We are here to assist in the process.

We welcome the opportunity to engage further on investor protection issues at the PCAOB. Thank you for your consideration of our recommendations. If you have any questions, please do not hesitate to contact Mary Bersot, mbersot@bersotcm.com or Lynn E. Turner, lynneturne@aol.com.

Sincerely,

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cc: Chair Gary Gensler, Securities and Exchange Commission