Alliance of Concerned Investors
Jane Adams
Jack Ciesielski
Rebecca McEnally
Janet Pegg
Lynn Turner

February 14, 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

Dear Chair Williams and PCAOB members:

We congratulate the new members of the PCAOB and applaud all of the members' public service. The PCAOB, created two decades ago, has a vitally important role overseeing the work of independent auditors. Indeed, the Sarbanes-Oxley Act of 2002 (SOX) states the PCAOB was established "…to protect the interest of investors, and further the public interest in the preparation of informative, accurate and independent audit reports for companies…." As occurred during the corporate scandals leading up to the creation of the PCAOB, investors and the capital markets quickly lose trust in financial disclosures when poor audits lack independence and result in misleading and omitted disclosures. In turn, the costs to investors can rise exponentially.

We are a collection of individuals who have worked in the capital markets for multiple decades. Our functional roles have been as buy-side and sell-side research analysts, accounting standard-setters and regulators, or accounting academics. All of us have one experience in common: we are fundamental investors who believe that all investors are empowered to make useful investment decisions only when they are provided with robust and timely financial information. We joined together because our common beliefs and interests in financial reporting and market regulation led us to bring voice to concerns we share about the current state of auditing and attestation standards setting, inspection, and oversight.

We believe the PCAOB has a major opportunity as well as a statutory obligation to ensure that:

1. Its professional standards provide reasonable assurance to investors that audited financial statements are materially accurate.
2. Auditors have fulfilled their obligations and responsibilities as gatekeepers for investors, the capital markets, and regulators such as the SEC.

Investors should be regarded not only as the principal clients of the PCAOB, consistent with SOX, but partners in the effort to improve audit outcomes and the efficiency and effectiveness of audits.

We have prepared the attached paper outlining priority recommendations for the Board. These recommendations cover each of the major functions of the PCAOB including:

1. Enforcement Activities
2. PCAOB Operations
3. Standard Setting Activities
4. Inspection Activities

Thank you for your consideration of these recommendations as you undertake your new roles at the PCAOB. We believe your ability to successfully complete the recommendations will serve the mission of the PCAOB and protect investors. In doing so, it will enhance how investors and the public perceive the role and importance of the Board.

We welcome the opportunity to discuss these matters further with the Board and its staff. Please direct any correspondence to us at AllianceOfConcernedInvestors@gmail.com.

Very truly yours,

/s/ Jane B. Adams
/s/ Jack Ciesielski
/s/ Rebecca McEnally
/s/ Janet Pegg
/s/ Lynn E. Turner

cc: Gary Gensler, Chairman, Securities and Exchange Commission

This letter is an expression of the individual views of the signers and not the views of our organizations or affiliates.

PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD PRIORITY RECOMMENDATIONS

Submitted by the Alliance of Concerned Investors

FEBRUARY 2022

1. PCAOB Enforcement Activities

The PCAOB has a major opportunity as well as a statutory obligation to ensure that its professional standards provide reasonable assurance to investors that audited financial statements are materially accurate and that the auditors have fulfilled their obligations and responsibilities as gatekeepers for investors, the capital markets, and regulators such as the SEC. However, a 2019 investigation by the Project On Government Oversight (POGO) found:

> [The PCAOB's]…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.[1]

The POGO report indicated that 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. Given that only 2% of the defective audits resulted in enforcement actions by the PCAOB, the PCAOB appears to have avoided exercising its enforcement authority and has failed to ensure that audits are of a high quality. Not only do auditors not have any meaningful incentive to

[1] 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/

adhere to audit quality requirements, but they also know nothing meaningful is going to happen if they don't.

We recommend that the PCAOB review its enforcement program and evaluate actions necessary to comply with its obligations to protect investors by taking all appropriate actions to ensure audits are of a high quality. Remedial efforts to improve audit quality can never be as effective in modifying behavior as pecuniary damages.

2. PCAOB Operational Priorities

Enhance the Transparency of the Board

The PCAOB needs to greatly enhance the transparency of the operations of the Board. To illustrate:

- The Board has failed to hold public meetings in recent years with its advisory groups.
- The Board has failed to have regular meetings and when it does have meetings, they are not public as are meetings of the SEC or FASB.
- Records of private meetings the PCAOB members have with external parties, consistent with the records required of the SEC, are not kept. This was highlighted during the trial of individuals involved with the KPMG scandal.
- The PCAOB has failed to solicit periodic public comment on its ongoing agenda.
- The PCAOB inspection reports, which could be of significant value to investors when determining audit quality, lack the necessary transparency and timeliness.
- The Board has failed to make public its operating rules, policies and procedures.

Nothing in the Sarbanes-Oxley Act of 2002 (SOX) precludes the PCAOB from taking action to bring transparency to its operations. Given the Board was established to improve the quality of audits, which enhance the transparency of disclosures by public companies, it is ironic the Board itself operates with such a high degree of opacity.

We applaud the PCAOB members for taking measures to reestablish its advisory boards. We are encouraged that this is being done transparently. We hope we will see many more steps follow. In that regard, we believe the Board should:

- Meet periodically in public meetings with its advisory boards and participate in the meeting discussions.
- Ensure investors have a voice on advisory boards.
- Permit the members of the advisory boards to have meaningful input in the setting of the agenda and structure of the meetings.

Transparent Rule Making with Public Comment

The PCAOB undertook rule making at the end of 2020 that relaxed the independence rules for auditors. Public comment was not solicited with respect to the changes. This stealth diminishing of independence rules is baffling and certainly disappointing given the lack of compliance with existing auditor independence rules. We recommend that when the PCAOB undertakes rule making, whether issuing new rules or revising existing rules, it do so in the sunshine including public deliberations and soliciting public comment. We urge the Board to codify these practices in its operating policies, procedures, and rules.

We also urge the Board to periodically solicit public comment on its agenda which should focus on the Board's mission of protecting and serving investors.

Investor Advocate

Since its inception, only one member of the PCAOB has had experience as an investment advisor, manager, or analyst using financial statements. To compensate for this deficit in viewpoint, we recommend the PCAOB establish an investor advocate position within the agency, similar to the position 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 Whistle Blower Policies and Procedures

The Board has found itself in disputes, including with prior board members and employees, which reflect on the integrity and transparency of the Board. We recommend that, as others suggested, 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.

3. PCAOB Standard Setting Activities

"Interim" Standards

The PCAOB was established in 2002, due in part to the failure of the auditing profession to establish and enforce high quality auditing standards that would protect investors. One of the PCAOB's initial actions was to accept provisionally—on an "interim basis"—the then-existing auditing standards written by the auditing profession and its Auditing Standards Board (ASB). Unfortunately, in the past twenty years, the PCAOB has failed to update and modify as needed more than half of these interim standards. We recommend that the PCAOB undertake a project to review and revise these remaining interim standards in a timely manner.[2]

[2] In August 2000, the Public Oversight Board issued *The Report and Recommendations of the Panel on Audit Effectiveness* and urged the AICPA's ASB to adopt certain forensic-type audit procedures that would be performed during a forensic audit phase or throughout an independent audit. The purpose of this recommendation was to enhance auditor skepticism, a need that continues to exist today. The recommendations were not acted upon prior to the PCAOB adopting its interim standards and should receive serious consideration by the Board.

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 regulators to study the auditing profession in the United States and issue a report with recommendations. In October 2008, over 13 years ago, the ACAP issued its report and recommendations to the PCAOB. The PCAOB has yet to act on many of those recommendations.

Nearly 7 years ago, the PCAOB initiated a project on audit quality indicators, *only to abandon it later*. This project was the result of investors requesting disclosure of information regarding the quality of audits to be utilized when voting on the reappointment of an auditor. The ACAP also made recommendations on disclosures and monitoring of audit quality and catastrophic risk with respect to audit firms on which investors and the capital markets rely.

We encourage the Board to begin rule-making that would restart the project on disclosure of audit quality indicators, encompassing such indicators at the auditing firm level and at the individual audit level. The objective of devising audit quality indicators is to improve the corporate governance of the large auditing firms while enhancing the transparency of those firms. Given the role they play in the capital markets, and the risks and costs they present to the markets when they fail, it is vital and fair that investors are given the information they need to assess the riskiness of those firms and the quality of the audits they provide.

An Auditor's Role Regarding Other Information in SEC Filings, such as an annual report, in addition to Audited Financial Statements.
The PCAOB's professional standards set forth the auditors' obligations and responsibilities for other information in SEC filings in addition to audited financial statements were initially established in the 1970's. While there have been subsequent updates to those standards, the basic approach used by auditors has not changed. Yet in the intervening years, the capital markets have dramatically changed while the business and the global economy has become increasing complex. Non-GAAP disclosures, EDGAR and data tagging, along with significant modifications to Management's Discussion and Analysis (MD&A) and disclosures of risks are now elements of routine communications with shareholders. 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 discussion and disclosure from which investors can make informed capital allocation decisions.

Unfortunately, the PCAOB's auditing and attestation standards are woefully outdated and fail to ensure the information being reported engenders the trust and confidence investors need. Indeed, it is common to see companies being challenged by regulators and investors alike with respect to non-GAAP numbers and "greenwashing" of climate-related disclosures.

We recommend that the PCAOB review and update (1) the existing auditing standards with respect to other information contained in annual reports and (2) its attestation concept standard, and develop (3) an attestation standard applicable to an independent auditor providing assurance on Environmental Social and Governance (ESG) and Non-GAAP disclosures, as was done in the 1980's for MD&A. The

PCAOB should consider convening a round table of individuals with appropriate expertise, including investors, when undertaking this project.

Auditor's Consideration of Noncompliance with Laws and Regulations

The PCAOB's own Investor Advisory Group (IAG) requested this item—the updating of the standard addressing auditor's consideration of noncompliance with laws and regulations— be added to the PCAOB's agenda. The IAG's recommendations included significant changes in the existing "interim" PCAOB standard, which was written over two decades ago by the auditing profession. The International Auditing and Assurance Board (IAASB) has revised its applicable standard in recent years making needed changes. This has also been the focus of work by the National Association of State Boards of Accountancy (NASBA).

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 effective for January 1997, twenty-five years ago. These standards are outdated given changes in the business operations and structures of the large international audit firms that audit most public companies[3], the way audits are conducted both in the U.S. and internationally, the practice of "outsourcing" portions of an audit to distant locations, technology advances, changes in auditor independence rules, and 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 disclosures to investors that would inform them prior to their 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, investors. In doing so, we urge the PCAOB to seek public input from investors and develop its own standard, rather than using a standard developed by another, less impartial 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 the Boards' 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*. The auditor and the audit committees too often dismiss these violations, without any disclosures to investors. This action leaves investors woefully uninformed not only with respect to such violations but

[3] As measured by market capitalization.

also the factors that were considered to determine that the auditor remained independent[4] given such violations.

As we understand it, this came about when the profession submitted a white paper to the PCAOB addressing how the auditing profession believes the PCAOB should address such auditor independence violations. Investors and other stakeholders were not afforded *any* let alone the same opportunity to provide public comment and input on this important matter. We urge the PCAOB to solicit public comment on the profession's white paper. The PCAOB should also develop requirements addressing how and why auditor violations of the PCAOB and SEC's independence rules are addressed and disclosed to investors.

Unfortunately, as previously mentioned, previous PCAOB Board members relaxed auditor's independence rules at the end of 2020 without the Board seeking public comment on its revisions.

<u>"Going Concern" Audit Opinions Should Provide Timely Information to Investors</u>
The PCAOB 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 who required "bailout funding" during the financial crisis yet received audit opinions that were identical or substantially the same both before the crisis and during the crisis when they received government (taxpayers) funding. These audit 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.

4. PCAOB Inspection Activities

<u>Improve Transparency of Inspections Findings</u>
The PCAOB inspections could provide useful information regarding the quality of independent audits. Instead, the PCAOB has provided an unwarranted shield to auditing firms who have not complied with the PCAOB's auditing standards and SEC's and PCAOB's independence standards. This is inconsistent with SOX which states the PCAOB was 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 of 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. While SOX Section 104(g)

---

[4] In 2000, the SEC adopted revisions to its auditor independence rules, Reg. 210.2-03(d) Quality Controls, which establish a very limited exception whereby an auditor's violation(s) will not negatively impact an audit firm's 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.

provides the Board shall not immediately make public its negative inspection findings with respect to an audit firm's quality controls, SOX established a one-year period to afford a firm the opportunity to correct any deficiencies. However, all too often, the Board has given the audit firms a much longer period, even up to multiple years, prior to issuing such findings. 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 and findings on quality controls in a prompt fashion thereafter.

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, and the basis for those selections.