

Statement
Of
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Before the Senate Subcommittee on Securities, Insurance and
Investment

On
The Role of the Accounting Profession in Preventing Another Financial
Crisis

Dirksen Senate Office Building

April 6, 2011

Thank you Chairman Reed and Ranking Member Crapo, for holding this hearing on an important issue to investors in America's capital markets. Investors receiving credible financial information is the "lifeblood" to the capital markets. It is paramount to confidence and ability of those markets to attract capital. In fact, the turmoil in the markets in recent years has no doubt had a very real negative effect on capital formation in this country and the ability of companies to obtain that capital.

Before I start, it might be worthwhile to provide some background on my experience. I have held various positions in the accounting profession for some 35 years. I started my career with one of the world's largest international accounting and auditing firms where I rose to become an audit and SEC consulting partner. I served as a CFO and vice president of an international semiconductor company that had audited financial statements. I have had the good fortune to be the Chief Accountant of the Securities and Exchange Commission ("SEC"). In addition, I have been a member of chaired audit committees of corporate boards of both large and small public companies, a trustee of a mutual fund and a public pension fund, and a professor of accounting. I have also used and relied on audits as director of research of a financial and proxy research firm. In 2007, Treasury Secretary Paulson appointed me to the U.S. Treasury Advisory Committee on the Auditing Profession ("ACAP"). I have also served on various advisory committees and task forces of the Financial Accounting Standards Board ("FASB"), and the Standing Advisory Group ("SAG") and Investor Advisory Group ("IAG") of the Public Company Accounting Oversight Board ("PCAOB").

Lessons Learned From the Crisis

Let me start by stating that if the financial system was working as intended, it is indeed scarier than the idea that the system failed. However, we hear some constantly repeating the theme of “Do No Harm” which is the equivalent of saying do nothing. And doing nothing would be the same as saying the system worked as intended.

The subcommittee presented three very worthwhile questions to those testifying today. They in essence ask the question of what lessons have we learned from the crisis and what changes should be made to prevent a repeat of this horrific event resulting in the Great Recession. This is a question not only of interest here in the United States, but also abroad where the European Commission and the British Parliament have undertaken to study the issue.

It also brings to mind the first hearing of the full Senate Banking Committee on the Dodd/Frank legislation on February 4, of 2009. At that hearing, Senator Shelby stated:

“...As I have said many times and will continue to say, I believe that before we discuss how to modernize our regulatory structure, or even before we consider how to address the current financial crisis, we need to first understand its underlying causes. If we don’t have a comprehensive understanding of what went wrong, we will not be able to determine with any degree of certainty whether our regulatory structure was sufficient and failed, or was insufficient and must change....this Committee should and must conduct a full and thorough investigation of the market practices, regulatory actions, and economic

conditions that led to this crisis. The Committee should hear testimony from all relevant parties and produce a written report of its findings...”

I believe Senator Shelby was right about the need for a comprehensive study and his comments are just as relevant today. I believe the PCAOB should undertake such a study of the role of the auditors and accounting profession in the financial crisis and issue a public report on its findings. Earlier this month, the Investor Advisory Group to the PCAOB urged such a study be undertaken citing a number of issues with respect to audits as set forth in the attached Exhibit A.

It is worth noting that in the past week, the House of the Lords in Britain issued such a report that was critical of the auditing profession and the ability to audit international accounting standards. In a good example of study in retrospective review of the crisis, the International Monetary Fund has also issued a self examining public report on the crisis which I believe is very valuable to addressing necessary changes. I believe such as retrospective review, in-depth study and report by not only the PCAOB, but also both the SEC and FASB should be undertaken and published.

At the same time, I have heard the calls from some in Congress to reopen the debate on the Dodd/Frank legislation. While there is debate between investors on one side, and the financial and business community on the other side about the need for, and impact of that legislation, I would urge Congress not to reopen the debate, until as Senator Shelby has suggested, an in-depth investigation by the Senate Banking Committee occurs to provide a basis for changes to be made.

Did the Profession Perform As Expected – Did it Protect Investors?

The first question asked by the subcommittee is:

1. Did the accounting profession perform as expected leading up to and during the financial crisis? Specifically:
 - a. Did auditors perform as expected during the financial crisis?
 - b. Did the public company audit provide informative, accurate, and independent reports to investors?
 - c. Should the auditors have provided advance warning to investors or others?
 - d. Did the accounting standards and financial statements provide investors, creditors, and others with adequate protections and accurate and reliable disclosures?
 - e. If not, what changes, if any, would you recommend.

The Role of the Auditor

The ultimate responsibility for the financial statements of a company rests with its management. In turn, audit committees of boards of directors are responsible for the oversight of the internal controls, financial reporting and audit process of a public company. It is important to state that auditors **DID NOT** create the financial crisis. They did not run the companies involved, did not make the uncollectible loans or enter into the toxic derivatives, and certainly did not prepare the financial statements issued to investors.

However, auditors did have an extremely important role as a gatekeeper to the capital markets both in the United States as well as abroad. Independent audits provide investors with

reasonable assurance – that is high but not absolute assurance - the financial statements are correct and complete within the boundaries of materiality. It is the objectivity – the independence – of the auditor that creates the value of an audit. Without that independence and objectivity, an audit has no value. As the increasing complexity of business transactions, products and structures result in more subjective accounting standards, they also continue to create the need for judgment on the part of auditors. Subjective, very judgmental decisions by the auditor also greatly enhance the need for objectivity and professional skepticism on the part of auditors.

Unfortunately, as described later on, gatekeepers including the auditors did play a role in the financial crisis. They failed to act on and provide information available to them to investors. This left investors much like the ship Titanic as it approached an unforeseen iceberg, without any red flags or warnings of the imminent dangers. In doing so, the auditors helped contribute to a crisis in confidence.

Lax and Untimely Accounting Standards

The auditor does audit to accounting standards established by the accounting standard setters. The quality, or lack thereof in those standards can significantly impact the quality of financial information investors receive.

The failure of the FASB to issued timely standards that protect investors is not a new situation and exposes long standing fundamental flaws in its structure and mission. In early 2008, Chairman Reed very appropriately wrote the accounting standard setters citing concerns about the accounting standards for off balance sheet debt that yet again allowed companies to hide

obligations from the view of investors, similar to what happened at Enron. One of those letters also noted that it is likely, despite lax standards the FASB issued in response to Enron, that some of the companies had likely not complied with the accounting standards raising questions as the quality of the audits that had been performed.¹ However, it is important to note the FASB originally issued its first standard creating the ability for companies to hide off balance sheet debt, FASB Standard No. 77, in December 1983, some 28 years ago. Prior to that, the applicable accounting standard required that financing transactions be reported as debt on balance sheets. And beginning soon after the issuance of the FASB's original standard, chief accountants of the SEC consistently warned the FASB that its standards needed significant change and improvement. Indeed, up to the very beginning of the financial crisis the FASB had been warned, and knew, its standard was deficient but failed to act promptly. Instead it chose to wait until after significant losses had been incurred by investors to take corrective action. And I for one am not yet convinced the most recent "fix" the FASB has put in place will be successfully in providing a remedy to the full extent of the problem.

In the past, the FASB also failed to issue other important standards on a timely basis. Some examples of this are:

¹ In a letter from then FASB chairman Herz, to Chairman Reed, it states:

"The FASB is not responsible for auditing, regulating, or enforcing the application of accounting standards and disclosure requirements. Thus, the observations discussed herein regarding the application of existing requirements is solely based on our discussions with various constituents and our reading of published financial reports and press articles and may carry with them the benefit of hindsight. Based on these discussions and readings, we have questions about compliance with the existing standards and requirements in the following areas:

- a. The use of QSPEs to securitize assets for which decisions were required that may have extended beyond those specified in legal documents.
- b. The completeness and reasonableness of probability assessments used in estimating expected losses for determining the primary beneficiary of a securitization entity.
- c. Whether all involvements with a securitization entity were considered in determining the primary beneficiary (including, for example, implied guarantees and support arrangements).
- d. The adequacy of disclosures made pursuant to the requirements.

1. In the 1990's, despite increasing volumes of derivatives, the FASB failed to update their standards in a timely manner for these transactions leading to large losses for such investors in such companies as Proctor & Gamble. After those losses had been incurred, the FASB did issue its standard No. 119 within a year, showing it can, act quickly. However, in this instance it was once again after the damage to investors had occurred.
2. In the 1990's, companies began to engage in inappropriate "earnings management" when the management of the business had failed, contributing to a number of corporate scandals at such companies as Waste Management, Xerox, and Rite Aid. Yet the FASB was slow to respond to the various schemes and devices management was using to manage earnings resulting in tens of billions of losses for investors.
3. The FASB, when its independence was impacted by actions of some in congress, was slow to respond to abuses in accounting for stock options.
4. Despite serious, if not fatal flaws, in AICPA Statement of Position 94-6, *Disclosure of Certain Significant Risks and Uncertainties*, evidenced by lack of such disclosures during the financial crisis, the FASB has failed to update this standard. This failure directly contributed to the lack of timely disclosures in financial statements of many financial institutions.
5. In August, 2000, the Panel on Audit Effectiveness established at the request of the SEC, recommended the FASB develop a new standard highlighting management's responsibility to assess and disclose if a company is able to continue as a viable "going concern." Yet a decade later, investors are still waiting for such disclosures from

management, especially in light of the number of financial institutions that required huge government bailouts to remain afloat.

6. In their August 2009 report, as well as on other occasions, members of the TARP Congressional Oversight Panel have noted it was virtually impossible to decipher from existing disclosures, the amount and magnitude – and value – of troubled assets in the financial statements of financial institutions. In a discussion held just this month at the PCAOB SAG meeting, a member of the FASB was unable to describe which of their standards required disclosure of such information in a concise, transparent fashion.
7. The FASB's own Investor Technical Advisory Committee (ITAC) a couple of years ago requested the FASB to adopt a disclosure framework to help fill in the "holes" in the FASB's own disclosure requirements. For example, while the SEC has rules requiring that disclosure be made when information is material and is necessary to prevent disclosures from being misleading, the FASB has no such requirement for financial statements. However, at a meeting this month of the PCAOB SAG, a member of the FASB indicated such a project would not be forthcoming any time soon.
8. There are differing views as to whether the Lehman "Repo 105" transactions complied with the FASB's standards or not. I believe the courts will be the judge of this. But one thing is certain, and that is; if the standard was complied with, it was an unacceptable standard. If it was not complied with, then one must ask where is the SEC enforcement action?

9. Investors have asked the FASB for many years to provide a standard that would provide greater and enhanced information with respect to the cash flows and liquidity of companies. No such standard has been forthcoming.
10. In the mid 1970's, the FASB issued a standard on how financings of assets using lease agreements should be accounted for. This has been considered a "flawed" standard almost from the date it was issued as it has allowed many financings to be hidden off balance sheet. The numbers of "fixes" the FASB has made, or attempted to make over the years, to this standard are too numerous to count. Decades later, the FASB is expected to issue within the next year a revised standard, but even that standard is currently going through revisions that some question.

The failure on numerous occasions of the FASB to issue timely standards that would provide the capital market participants with the information necessary to make informed decisions when allocating capital, has proven costly. Failed standards such as those related to off balance sheet debt and disclosures of risks and uncertainties have resulted in the capital markets being inefficient due to a lack of important information. It also has resulted in markets being unable to effectively discipline themselves. Any notion that "free markets" can and will regulate themselves has gone out the window.

At the same time, the FASB is about to issue several very significant new standards that are going to fundamentally change how companies do their accounting. Without appropriate consideration being given to the implementation dates, and whether the numbers resulting from those standards can be verified by the auditors, the quality of transparency and

financial reporting in the U.S. capital markets and investors could suffer greatly. It is very important the FASB closely coordinate their work with that of the PCAOB in this regards.

Auditor Performance and Communication

On Monday of this week, the current chairman of the PCAOB stated in an address to investors:

“A deeper analysis of what motivates auditors' behavior is underway. Indeed, the PCAOB inspected the audits of many of the issuers that later failed or received federal bail-out funds. In several cases — including audits involving substantial financial institutions — PCAOB inspection teams found audit failures that were of such significance that our inspectors concluded the firm had failed to support its opinion.

Several of these audits are now also the subject of pending PCAOB investigations and may lead to disciplinary actions against firms or individuals. Under the Sarbanes-Oxley Act, our disciplinary actions must remain non-public (unless the respondent consents), until both our proceeding and any SEC appeal are finished.”

It should be no surprise that investors both in the U.S. and abroad, are asking “where were the auditors?” The findings of the PCAOB and others have raised a question as to whether auditors were in fact acting as objective examiners of the financial reports. Some have also questioned whether the auditors maintained the requisite level of professional skepticism

as they performed their audits. Others are questioning the fundamental value of an audit in today's digital world and whether audits are relevant.

As noted in Exhibit A, several financial institutions failed or required government bailouts yet the companies received "clean" opinions from their auditors. "Going Concern" opinions in which auditors discuss the uncertainty of a company's ability to continue under the circumstances were in short supply, if not outright rare. The auditors also failed to give warnings with respect to off balance sheet debt that should have been on the financial statements. And they failed to warn of significant risks and uncertainties, albeit the disclosure standard in this regards is substandard at best.

Exhibit B sets forth the auditor reports on financial institutions that received significant amounts in the government bailout. Yet as a reader can see, the auditor reports issued on these institutions in early 2009 at the height of the financial crisis, when we were warned the financial system was on the verge of a total meltdown, contained no additional information or "red flags" when compared to the very same audit reports for the fiscal year ending in 2006, just at the peak of the economy and as the financial crisis began to unfold.

But this is not the first time shortcomings in auditor's communication with investors have been noted. Surveys conducted by Chartered Financial Analysts (CFA) have shown on more than one occasion that investors believe auditors need to communicate more than what is

currently communicated in the standard auditors boilerplate report. The PCAOB's own IAG conducted a survey that found:²

- 45% of respondents believe the current audit report does not provide valuable information that is integral to understanding financial statements (23% of respondents believe the current audit report provides valuable information)
- 73% of respondents skim the report quickly for departures from the standard unqualified report while 18% believe it is of no use to them at all (7% read the full report)

In 2007, then Treasury Secretary Henry Paulson established a bi-partisan committee that included corporate board members, investors, auditors, lawyers, former regulators and academics to study the auditing profession. This US Treasury Advisory Committee on the Auditing Profession is often referred to as the "ACAP" committee. Former SEC Chairman Arthur Levitt, Former Federal Reserve Chairman Paul Volcker, Rodgin Cohen the chairman of Sullivan & Cromwell LLP, the Chairman and CEO of Xerox Ann Mulcahy and the Chairman of KPMG LLP Timothy Flynn were all members of this committee. It spent over a year studying the auditing profession and firms, held numerous public meetings and hearings, requested significant and important information from the profession, some of which was provided and some withheld, received public testimony from dozens including the profession, investors, lawyers and representatives from the business community. The report of this committee highlighted shortcomings in the report used by auditors to

² See PCAOB website http://pcaobus.org/News/Events/Pages/03232011_SAGMeeting.aspx for copies of the IAG presentations to the PCAOB.

communicate with investors; the standards auditors use to detect fraud; and the governance and transparency of the auditing firms. In fact, shortcomings cited by this report have become even more self evident as a result of the financial crisis.

What Changes Are Needed?

The Subcommittee has also asked the questions:

2. What, if any, improvements have been made or should be made by the U.S. Securities and Exchange Commission, the Financial Accounting Standards Board, or the Public Company Accounting Oversight Board as a result of the financial crisis?
3. What, if any, policy changes should Congress consider?

Improving Accounting Standard Setting and the FASB

The ongoing and continued inability of the FASB to issue timely standards that protect investors calls into question the fundamental structure and composition of the FASB. Its standards have become increasingly complex, in part due to the increasing complexity of structured and engineered financial transactions, and in part due to requests of the business community for “compromises”. What is uncertain is whether or not in each instance, the increasing complexity is serving investors well. I believe this is in part because the end user of financial reports are under represented among the actual voting members of the FASB, as well as its Emerging Issues Task Force which also issues a significant amount of guidance.

In addition, in the past the FASB has failed to study on a timely basis, whether its new standards are achieving their stated objectives, have been implemented as intended, or require changes. As noted earlier, this has resulted in flawed standards existing that have led to investor losses. More recently the trustees of the FASB have instituted a process to review standards on a more timely and systematic basis. That process will be led by a former auditor. What is not readily transparent is what input investors will have into that process. In addition, it is vitally important that the SEC who has to oversee implementation of new standards, and the PCAOB who has to oversee the auditing of those new standards have a strong voice in that review process.

However, I believe it may be time to reconsider the recommendations of some who testified before the Senate Banking Committee that a better model would be to include both the accounting and auditing standard setting under the same oversight board, the PCAOB. This view was previously expressed by the former Comptroller of the US and head of the General Accountability Office (“GAO”) and others. I believe it warrants serious study, if not adoption at this time.

In the meantime, the independence of the FASB needs to be fostered. Unfortunately, in recent years, some members of Congress have eroded that independence. This has resulted in numbers being reported by financial institutions being called into question, at a time when confidence in those numbers is vitally important. It seems as if Congress agrees the FASB’s independence is important – but only so long as some constituency isn’t being pushed towards greater transparency by the FASB. I would hope that someday Congress

can find a better balance between its oversight responsibilities with respect to accounting standard setting, the need for millions of American investors to receive transparent information, and the demands of special interest groups.

Improving the Value of Audits

The PCAOB has several new board members and a new chairman. I believe this provides a new opportunity for the board to demonstrate its value to investors, the auditing profession, and the capital markets. I applaud their beginning efforts to act to improve the quality of audits and investor protection. However, much work remains.

The PCAOB should undertake the study of the auditing profession as urged to do so by its own IAG. This is consistent with past calls for a thorough investigation of the financial crisis by Senator Shelby.

In the meantime, a number of improvements can be made that will enhance the quality of audits. For starters, Congress can respond to requests of the current and past chairs of the PCAOB to allow the agency to make their investigations public in the same manner the SEC makes its proceedings against auditors' public. Transparency is important to the credibility of the PCAOB. Its dearth of announced enforcement actions against the large audit firms has challenged that credibility as has the PCAOB's reluctance to provide investors with information that would identify which audits have been substandard.

The recommendations of the US Treasury ACAP Committee, included as Exhibit C, should be acted upon by the PCAOB and SEC in a timely manner. These recommendations to both the

PCAOB and SEC have already been outstanding for over two and a half years without results.

The PCAOB should also act on the recommendations of its own IAG which are included as Exhibit D. Many of these recommendations are also consistent with or similar to those in the ACAP report. This includes improving the standard auditor report so that it provides information of value to investors.

The auditing standard with respect to detection of fraud needs to be revisited. It also includes enhancing the transparency and governance of the auditing firms so that the PCAOB is not left in the dark, as they are now, with respect to the financial viability and stability of these large firms. That is not to say they firms should be treated as “too big too fail” which they should not, but that the PCAOB as their regulator should be in an informed position to proactively act if necessary when a firm has created systemic risk.

Finally, the PCOAB has described instances that call into question the objectivity of auditors, the very foundation upon which each and every audit rests. As the PCAOB studies the profession, is should consider whether as it own IAG has recommended, there are steps it should take to ensure that auditors continue to remain independent of those they are examining, with the requisite degree of professional skepticism. Recent findings by investors, the SEC and PCAOB with respect to audits of Chinese companies listed in the United States would strongly indicate auditors and audits are falling short of their target.

Improving the Transparency of Audit Committees

Some have expressed a view that the audit committees should play a key role in enhancing and improving the transparency of the audit process. I agree.

I was chief accountant at the SEC at the time the Blue Ribbon Panel on Improving the Effectiveness of Audit Committees issued its report well over a decade ago. At that time, this stellar and widely respected panel set forth recommendations which have improved audit committees. However, further enhancements are necessary especially with respect to what audit committees communicate to investors. For example audit committees should inform investors as to how the audit committee has overseen the audit and financial reporting processes. Others such as Warren Buffet have also recommended there be greater transparency with respect to the discussions between audit committees, auditors, and financial management, including with respect to internal controls, completeness of disclosures and whether adjustments are needed to reported numbers or not. As an audit committee chair, I have implemented these recommendations by Mr. buffet and found them to be beneficial to the members of the committee as well as investors. As a result, I believe the SEC should undertake to update the rules with respect to reports by audit committees.

The SEC has also recently taken an enforcement action against members of an audit committee found to be derelict in a financial fraud. The SEC deserves credit for establishing accountability of these audit committees. However, given revelations of the Financial Crisis Inquiry Commission and the examiner's report on Lehman, one must ask why there haven't been more similar actions. Ultimately, it is important that audit committee members be

held accountable for their actions, or lack of actions. Enhanced transparency will no doubt aid in establishing greater accountability.

Improvements at the SEC

With respect to the SEC, it needs to exercise greater oversight of the FASB standard setting process. This includes overseeing those appointed to both the FASB itself as well as its trustees. This requires balancing the need to observe the independence of the FASB with the fact it has consistently failed to put out a product that provides investor protection.

Clearly the FASB has failed to develop quality and timely standards and this begins and ends with the members of its board, and those who oversee its efforts. One likely cause of this is the FASB has a very diluted mission and objective of trying to serve all – auditors, financial management who prepares financial statements as well as investors. When one is tasked to serve all, it often results in none being served. Changing the mission of the FASB to specifically state it serves investors would certainly clarify and help strengthen the Board.

The SEC also needs to ensure it enforces the standards that do exist. There appears to be a lack of enforcement cases related to financial reports these days, as evidenced by the lack of action discussed in the report of the examiner of Lehman. Without strong enforcement of standards, there are in fact, no standards.

While the SEC enforcement division has set up several task forces, it has failed to establish any task force to examine financial reporting fraud. I believe this indicates a lack of focus on an area of fraud that has cost investors large losses, and is necessary if investors are to believe that the agency is clearly the “investors advocate.”

At the same time, the SEC needs the necessary resources and tools to do its job. I have met with staff at the SEC and found that they do in fact lack the tools for the job. They don't have the necessary information technology necessary for monitoring the markets and market participants. They lack many of the technologies and tools those they regulate have and use. And as the recent Boston Consulting Report confirmed, they do not have enough or the right people to do the job they have now been tasked to do.

This is not an issue of "balancing the budget" as the funding for the SEC does not involve any taxpayer dollars. Rather its funding comes from fees that ultimately investors bear the cost of. And time and time again, investors have stated they are willing to bear those costs. Accordingly, failure to fund the SEC can only be viewed as an intentional and deliberate effort to handcuff this law enforcement agency, thereby exposing investors to substantial harm, as in the past.

I have been at the SEC at times when it was "starved" by Congress, effectively ensuring a lack of regulation and exposure of millions of Americans to great risk of loss. Indeed, Congresses own GAO has stated in the past the SEC has been woefully underfunded. I believe the lack of such underfunding has directly led to a lack of confidence in the US capital markets while tens of millions of investors watched trillions in value in their pensions and 401-K's disappear.

If Congress believes the SEC needs to become more efficient and effective, then Congress is obligated to hold oversight hearings to ensure the agency spends the resources it receives wisely and effectively. But this should not be an excuse to defund the agency, at a time

when tens of millions of American investors need it more than ever before. I will also add the same is true for the CFTC.

What is Not Needed

One of the key issues the ACAP committee deliberated and debated at length was the issue of further liability reforms requested by the audit firms. However, as the ACAP report aptly describes in detail, there was strong disagreement among the members of the committee as to whether such reforms were in fact necessary or not.

The audit firms cited the need for further reforms as they are required to exercise judgment. Yet auditors have been required to exercise significant judgments when performing audits for many decades. Unfortunately, some of those judgments on audits such as Waste Management, Enron, Lehman, and Xerox have been correctly called into question, not only by investors and their lawyers, but also by regulators and others.

What the evidence provided in reports by Cornerstone Research and the Stanford Law School Securities Class Action Clearinghouse demonstrate as set forth in Exhibit E, is that lawsuits naming the auditor as a defendant have dramatically declined since the passage of the Private Securities Law Reform Act (“PSLRA”) in 1995. Subsequent court cases have also further narrowed the ability of investors to recover from auditors through establishment of higher hurdles for proving loss causation and elimination of cases involving aiding and abetting of securities fraud. In fact, despite over 14,000 audit opinions issued on an annual basis by auditors of public entities, almost 4900 restatements of financial statements being reported during the years 2005 through 2010, and a significant increase in the number of

violations of the Foreign Corrupt Practices Act (“FCPA”), there has been on average less than one class action lawsuit brought each year against each of the ten largest auditing firms during that same period. As a result it is not surprising the ACAP was unable to reach a consensus that any further litigation reform is necessary for auditors.

Closing Comments

Audits, when properly performed by truly objective and independent auditors, provide the capital markets with confidence the financial statements can be trusted. However, investors are questioning the value proposition of audits today, including the information they are provided and how auditors communicate that information to them. As a result, it is important auditors provide a product to their real client – investors – that the customer believes is worth the price being paid. If on the other hand, investors continue to question the relevance of the audit, the audit report and the information being reported, it will only be a matter of time in this digital age before audits do indeed lose their value and relevance.

I would be happy to respond to any questions members of the Subcommittee might have.

EXHIBIT A

**“PRESENTATION OF THE PCAOB INVESTOR ADVISORY GROUP SUBCOMMITTEE
ON LESSONS LEARNED FROM THE FINANCIAL CRISIS**

MARCH 16, 2011

EXHIBIT B

SAMPLE AUDIT REPORTS ON FINANCIAL INSTITUTIONS

RECEIVING FEDERAL BAILOUT FUNDS

FOR FISCAL YEARS 2006 AND 2008

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of Bank of America Corporation:

We have completed integrated audits of **Bank of America Corporation's** Consolidated Financial Statements and of its internal control over financial reporting as of **December 31, 2006**, in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

Consolidated Financial Statements

In our opinion, the accompanying Consolidated Balance Sheet and the related Consolidated Statement of Income, Consolidated Statement of Changes in Shareholders' Equity and Consolidated Statement of Cash Flows present fairly, in all material respects, the financial position of Bank of America Corporation and its subsidiaries at December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America. These Consolidated Financial Statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these Consolidated Financial Statements based on our audits. We conducted our audits of these Consolidated Financial Statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

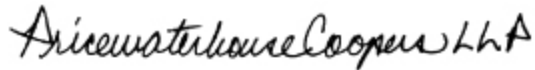
Internal control over financial reporting

Also, in our opinion, management's assessment, included in the Report of Management on Internal Control Over Financial Reporting, that the Corporation maintained effective internal control over financial reporting as of December 31, 2006 based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control—Integrated Framework* issued by the COSO. The Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Corporation's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable

assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.



Charlotte, North Carolina

February 22, 2007

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders

of Bank of America Corporation:

In our opinion, the accompanying Consolidated Balance Sheet and the related Consolidated Statement of Income, Consolidated Statement of Changes in Shareholders' Equity and Consolidated Statement of Cash Flows present fairly, in all material respects, the financial position of Bank of America Corporation and its subsidiaries at December 31, 2008 and 2007, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2008 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Corporation's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the Report of Management on Internal Control Over Financial Reporting appearing on page 108 of the 2008 Annual Report to Shareholders. Our responsibility is to express opinions on these financial statements and on the Corporation's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As discussed in *Note 19 – Fair Value Disclosures* to the Consolidated Financial Statements, as of the beginning of 2007 the Corporation has adopted SFAS No. 157, "Fair Value Measurements" and SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities."

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Charlotte, North Carolina

February 25, 2009

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM— CONSOLIDATED FINANCIAL STATEMENTS



The Board of Directors and Stockholders
Citigroup Inc.:

We have audited the accompanying consolidated balance sheets of **Citigroup Inc.** and subsidiaries (the “Company” or “Citigroup”) as of **December 31, 2006** and 2005, the related consolidated statements of income, changes in stockholders’ equity and cash flows for each of the years in the three-year period ended December 31, 2006, and the related consolidated balance sheets of Citibank, N.A. and subsidiaries as of December 31, 2006 and 2005. These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Citigroup as of December 31, 2006 and 2005, the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2006, and the financial position of Citibank, N.A. and subsidiaries as of December 31, 2006 and 2005, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, in 2006 the Company changed its methods of accounting for defined benefit pensions and other postretirement benefits, stock-based compensation, certain hybrid financial instruments and servicing of financial assets, and in 2005 the Company changed its method of accounting for conditional asset retirement obligations associated with operating leases.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Citigroup’s internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 23, 2007 expressed an unqualified opinion on management’s assessment of, and the effective operation of, internal control over financial reporting.

KPMG LLP

New York, New York
February 23, 2007

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM— CONSOLIDATED FINANCIAL STATEMENTS



The Board of Directors and Stockholders
Citigroup Inc.:

We have audited the accompanying consolidated balance sheets of **Citigroup Inc.** and subsidiaries (the “Company” or “Citigroup”) as of **December 31, 2008** and 2007, and the related consolidated statements of income, changes in stockholders’ equity and cash flows for each of the years in the three-year period ended December 31, 2008, and the related consolidated balance sheets of Citibank, N.A. and subsidiaries as of December 31, 2008 and 2007. These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Citigroup as of December 31, 2008 and 2007, the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2008, and the financial position of Citibank, N.A. and subsidiaries as of December 31, 2008 and 2007, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, in 2007 the Company changed its methods of accounting for fair value measurements, the fair value option for financial assets and financial liabilities, uncertainty in income taxes and cash flows relating to income taxes generated by a leverage lease transaction.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Citigroup’s internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated February 27, 2009 expressed an unqualified opinion on the effectiveness of the Company’s internal control over financial reporting.

/s/ KPMG LLP
New York, New York
February 27, 2009

EXHIBIT C

RECOMMENDATIONS OF THE US TREASURY ADVISORY COMMITTEE

ON THE AUDITING PROFESSION

FINAL ACAP RECOMMENDATIONS

Human Capital Recommendations

Recommendation 1. Implement market-driven, dynamic curricula and content for accounting students that continuously evolve to meet the needs of the auditing profession and help prepare new entrants to the profession to perform high quality audits.

- a) Regularly update the accounting certification examinations to reflect changes in the accounting profession, its relevant professional and ethical standards, and the skills and knowledge required to serve increasingly global capital markets.
- b) Reflect real world changes in the business environment more rapidly in teaching materials.
- c) Require that schools build into accounting curricula current market developments.

Recommendation 2. Improve the representation and retention of minorities in the auditing profession so as to enrich the pool of human capital in the profession.

- a) Recruit minorities into the auditing profession from other disciplines and careers.
- b) Institute initiatives to increase the retention of minorities in the profession.
- c) Emphasize the role of community colleges in the recruitment of minorities into the auditing profession.
- d) Emphasize the utility and effectiveness of cross-sabbaticals and internships with faculty and students at Historically Black Colleges and Universities.
- e) Increase the numbers of minority accounting doctorates through focused efforts.

Recommendation 3. Ensure a sufficiently robust supply of qualified accounting faculty to meet demand for the future and help prepare new entrants to the profession to perform high quality audits.

- a) Increase the supply of accounting faculty through public and private funding and raise the number of professionally qualified faculty that teach on campuses.
- b) Emphasize the utility and effectiveness of cross-sabbaticals.
- c) Create a variety of tangible and sufficiently attractive incentives that will motivate private sector institutions to fund both accounting faculty and faculty research, to provide practice materials for academic research and for participation of professionals in behavioral and field study projects, and to encourage practicing accountants to pursue careers as academically and professionally qualified faculty.

Recommendation 4. Develop and maintain consistent demographic and higher education program profile data.

Recommendation 5. Encourage the AICPA and the AAA jointly to form a commission to provide a timely study of the possible future structure of higher education for the accounting profession.

Firm Structure and Finances Recommendations

Recommendation 1. Urge the SEC, and Congress as appropriate, to provide for the creation by the PCAOB of a national center to facilitate auditing firms' and other market participants' sharing of fraud prevention and detection experiences, practices, and data and innovation in fraud prevention and detection methodologies and technologies, and commission research and other fact-finding regarding

fraud prevention and detection, and further, the development of best practices regarding fraud prevention and detection.

Recommendation 2. Encourage greater regulatory cooperation and oversight of the public company auditing profession to improve the quality of the audit process and enhance confidence in the auditing profession and financial reporting.

- a) *Institute the following mechanism to encourage the states to substantially adopt the mobility provisions of the Uniform Accountancy Act, Fifth Edition (UAA). If states have failed to adopt the mobility provisions of the UAA by December 31, 2010, Congress should pass a federal provision requiring those states to adopt these provisions.*
- b) *Require regular and formal roundtable meetings of regulators and other governmental enforcement bodies in a cooperative effort to improve regulatory effectiveness and reduce the incidence of duplicative and potentially inconsistent enforcement regimes.*
- c) *Urge the states to create greater financial and operational independence of their state boards of accountancy.*

Recommendation 3. Urge the PCAOB and the SEC, in consultation with other federal and state regulators, auditing firms, investors, other financial statement users, and public companies, to analyze, explore, and enable, as appropriate, the possibility and feasibility of firms appointing independent members with full voting power to firm boards and/or advisory boards with meaningful governance responsibilities to improve governance and transparency at auditing firms.

Recommendation 4. Urge the SEC to amend Form 8-K disclosure requirements to characterize appropriately and report every public company auditor change and to require auditing firms to notify the PCAOB of any premature engagement partner changes on public company audit clients.

Recommendation 5. Urge the PCAOB to undertake a standard-setting initiative to consider improvements to the auditor's standard reporting model. Further, urge that the PCAOB and the SEC clarify in the auditor's report the auditor's role in detecting fraud under current auditing standards and further that the PCAOB periodically review and update these standards.

Recommendation 6. Urge the PCAOB to undertake a standard-setting initiative to consider mandating the engagement partner's signature on the auditor's report.

Recommendation 7. Urge the PCAOB to require that, beginning in 2010, larger auditing firms produce a public annual report incorporating (a) information required by the EU's Eighth Directive, Article 40 Transparency Report deemed appropriate by the PCAOB, and (b) such key indicators of audit quality and effectiveness as determined by the PCAOB in accordance with Recommendation 3 in Chapter VI of this Report. Further, urge the PCAOB to require that, beginning in 2011, the larger auditing firms file with the PCAOB on a confidential basis audited financial statements.

Concentration and Competition Recommendations

Recommendation 1. Reduce barriers to the growth of smaller auditing firms consistent with an overall policy goal of promoting audit quality. Because smaller auditing firms are likely to become significant competitors in the market for larger company audits only in the long term, the Committee recognizes that Recommendation 2 will be a higher priority in the near term.

- a) *Require disclosure by public companies in their registration statements, annual reports and proxy statements of any provisions in agreements with third parties that limit auditor choice.*
- b) *Include representatives of smaller auditing firms in committees, public forums, fellowships, and other engagements.*

Recommendation 2. Monitor potential sources of catastrophic risk faced by public company auditing firms and create a mechanism for the preservation and rehabilitation of troubled larger public company auditing firms.

- a) *As part of its current oversight over registered auditing firms, the PCAOB should monitor potential sources of catastrophic risk which would threaten audit quality.*
- b) *Establish a mechanism to assist in the preservation and rehabilitation of a troubled larger auditing firm. A first step would encourage larger auditing firms to adopt voluntarily a contingent streamlined internal governance mechanism that could be triggered in the event of threatening circumstances. If the governance mechanism failed to stabilize the firm, a second step would permit the SEC to appoint a court-approved trustee to seek to preserve and rehabilitate the firm by addressing the threatening situation, including through a reorganization, or if such a step were unsuccessful, to pursue an orderly transition.*

Recommendation 3. Recommend the PCAOB, in consultation with auditors, investors, public companies, audit committees, boards of directors, academics, and others, determine the feasibility of developing key indicators of audit quality and effectiveness and requiring auditing firms to publicly disclose these indicators. Assuming development and disclosure of indicators of audit quality are feasible; require the PCAOB to monitor these indicators.

Recommendation 4. Promote the understanding of and compliance with auditor independence requirements among auditors, investors, public companies, audit committees, and boards of directors, in order to enhance investor confidence in the quality of audit processes and audits.

- a) *Compile the SEC and PCAOB independence requirements into a single document and make this document website accessible. The AICPA and state boards of accountancy should clarify and prominently note that differences that exist between the SEC and PCAOB standards (applicable to public companies) and the AICPA and state standards (applicable in all circumstances, but subject to SEC and PCAOB standards, in the case of public companies) and indicate, at each place in their standards where differences exist, that stricter SEC and PCAOB independence requirements applicable to public company auditors may supersede or supplement the stated requirements. This compilation should not require rulemaking by either the SEC or the PCAOB because it only calls for assembly and compilation of existing rules.*
- b) *Develop training materials to help foster and maintain the application of healthy professional skepticism with respect to issues of independence and other conflicts among public company auditors, and inspect auditing firms, through the PCAOB inspection process, for independence training of partners and mid-career professionals.*

Recommendation 5. Adopt annual shareholder ratification of public company auditors by all public companies.

Recommendation 6. Enhance regulatory collaboration and coordination between the PCAOB and its foreign counterparts, consistent with the PCAOB mission of promoting quality audits of public companies in the United States.

EXHIBIT D

RECOMMENDATIONS OF THE PCAOB INVESTOR ADVISORY GROUP

1. Standard auditor's report should be revised to include more useful information to investors.
2. The PCAOB should launch an in-depth study into the role auditors played in the financial crisis. The goal of that study should be to identify both the causes of and remedies for those pervasive audit failures. The PCAOB should make such analysis of audit failures an ongoing function of the Board, in order to ensure that changes in policy and oversight practices are adopted in a timely fashion to address correctable weaknesses in the audit process.
3. The firms should produce an annual report, including financial statements, which is filed with the PCAOB and made public and certified to by the executives of the firm. The annual report of the audit firm should include its key quality control factors, global quality control processes, and how it is structured and operates.
4. The PCAOB should require the governing boards of the firms, either on the board itself or on an advisory board, appoint no less than 3 independent members. These independent members should include in the annual report of the firm, a report on their activities for the year.
5. The PCAOB should continue to ask congress to pass legislation that will allow it to make its disciplinary proceedings public.
6. The PCAOB should undertake a project to establish mandatory rotation of the auditor, ofr example every ten years. During that time period, to strengthen auditor independence and avoid any "opinion shopping", any rules adopted should permit the auditor to be removed only for cause, as defined by the PCAOB.
7. The PCAOB as it updates its standards should undertake to study and strengthen the supervision by the lead audit partner, of the foreign audit work performed. Mere acceptance of foreign auditors "credentials" is insufficient to ensure high quality audits.
8. The auditor's report should be modified to state the amount or percentages of assets and revenues that have been audited by any auditors, who has refused to be inspected by the PCAOB. We support the PCAOB's efforts to negotiate joint inspection agreements with foreign regulators. However, we do not believe mere reliance on those regulators inspections, without first determining and monitoring their quality, is an acceptable protection for investors.
9. Consistent with the recommendations of the Panel on Audit Effectiveness, we recommend the PCAOB revise its standards to require forensic auditing procedures and include greater guidance on the forensic audit procedures that should be performed. This should include requiring auditors to understand the whistle blower programs and their independence and effectiveness.

Exhibit E

Data on Securities Litigation and Restatements

Class action filings naming auditors as defendant:

	Annual Number	Percentage of annual filings
<u>Year</u>	<u>Of Class Action Filings</u>	<u>Naming Auditor Defendant</u>
2010	176	4%
2009	168	6%
2008	223	3%
2007	177	1%
2006	119	3%
2005	182	3%

Restatements: source Audit Analytics.

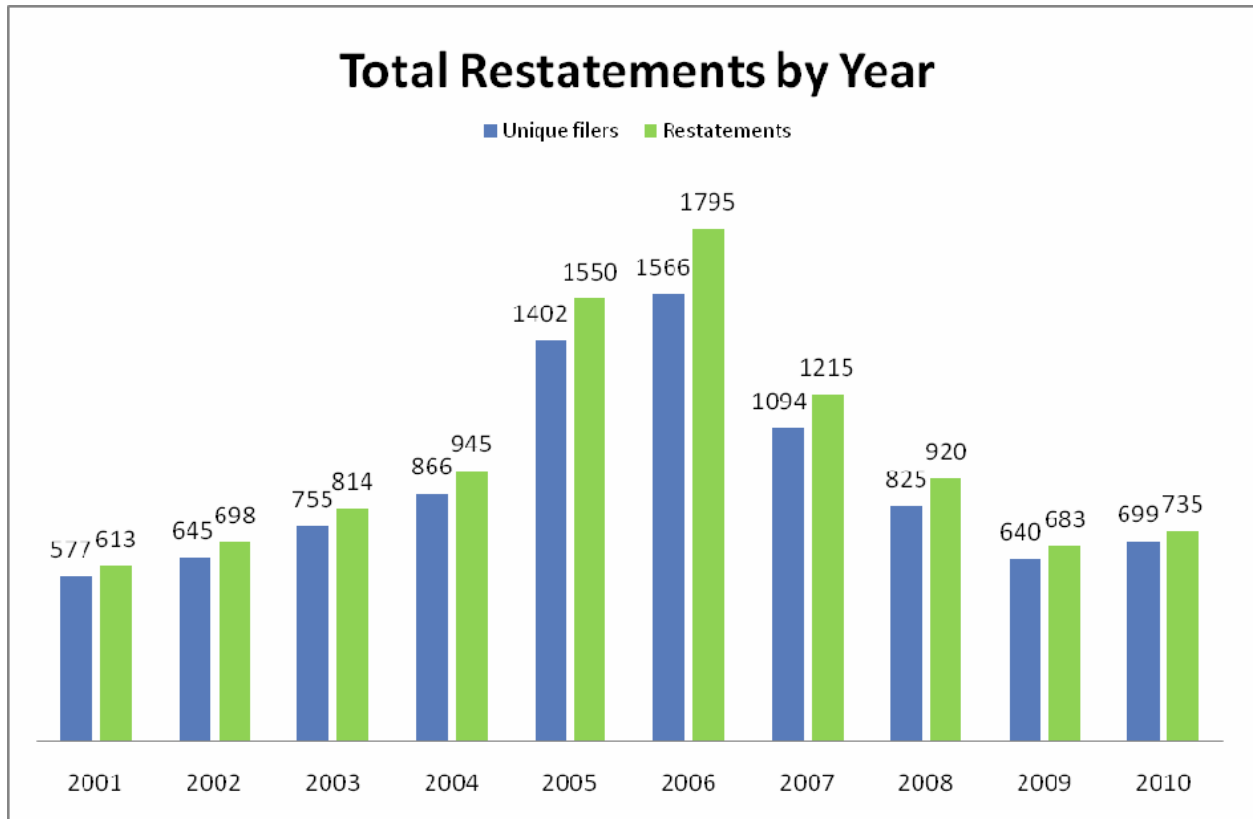


Exhibit 11. The Number of FCPA Settlements Reached a Post-SOX High in FY10

