Advisory Committee on the Auditing Profession
February 4, 2007
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The author acknowledges with deep appreciation the assistance of Elizabeth Mooney, Mel Spinella and Brian Bullard, all of Capital Research and Management Company (CRMC), in preparing these comments. These reflect the views of the authors and not necessarily those of CRMC.

The audits of public companies should be designed to protect investors and to ensure that the underlying financial statement judgments are transparent and in conformity with accounting standards.

On the basis of the above statement, we have provided the following recommendations for your consideration.

I. The Auditing Firm and the Audit Organization, Financial Resources, and Communication.

- We are in support of the creation of a national license for Certified Public Accountants under the auspices of the AICPA. The rotation of audit partners will continue to require the interstate movement of audit partners, especially for specialized industries such as banking, insurance, investment management, etc. A national license would ensure a minimum standard while also eliminating the need for audit partners to obtain multiple state licenses.

- We would support broad reform for the system of litigation in the U.S., but we do not believe that providing audit firms a safe harbor or business judgment rule is necessary at this time. Investors place reliance on auditors as experts who spend a significant amount of time examining the companies they audit. The judgments made by the auditors should be informed by their expertise and time spent on the audit engagements. Recent history has shown that these judgments have been poor in so many instances that we believe it is unwarranted to provide a safe harbor for judgments related to historical numbers and to take away the deterrent of litigation.

- Similarly, we do not believe that liability caps are necessary. We note that there has been a significant reduction in litigation due to market reform, and we would support further reform of the litigation system including revising the standard for bringing litigation or requiring the losing party to pay legal fees of the prevailing party. The value of audits might be diminished if the auditors had safe harbors, liability caps and immunity.

- In an effort to improve governance, we are strongly in favor of requiring an independent board for all auditing firms of public companies. This independent board should select its own members. Oversight would include issues that typical boards are responsible for including choosing a CEO and partner compensation, and also include monitoring audit quality, potential conflicts and the quality of services provided by the audit firm.

- In an effort to improve transparency, audit firms should also facilitate and ensure the public disclosure of:
  - the reason for any change in audit partners on an engagement (other than normal rotation), and disclosure when a firm removes a partner from an audit engagement, if done for any reason at the request of a company
  - any liability indemnifications, required arbitration and liability caps in audit engagement letters (this should be disclosed in the proxies of public companies)
  - ethical guidelines
  - quality control policies and procedures
  - audited GAAP financial statements

- We believe that individual audit partners should sign their own names on the audit, in addition to the name of the firm. This could increase the sense of accountability and improve quality similar to the requirement for CEOs and CFOs signing 10Ks and internal control representations.

- Improved disclosures regarding company estimates in the financial statements, and the judgments that auditors have to make about the judgments that companies have made, should go a long way toward protecting auditors and making financial statements more useful.

II. Auditing Profession Structure: Competition, Concentration, Independence and Other Professional Standards.

- Fundamental change in the determination or payment of the audit fee is unnecessary. The strengthened audit committee role in engaging the auditors and setting the audit fees that resulted from the Sarbanes Oxley Act was an important improvement.

- Auditor independence standards need to be refined to reflect the complicated corporate structure of large multi-national financial organizations. The current auditor independence rules are too broad and try to eliminate all possible appearances of conflict instead of focusing on actual conflicts of interest that might have a bearing on auditor independence.

- Auditor independence rules need to be centralized in a national standard setter to eliminate the complicated environment that exists today where each state has its own set of independence standards.

- The independence standards adopted as a result of SOX have effectively shifted the balance between audit and non-audit services to an acceptable level that addresses potential conflicts.

- The partner rotation rules adopted after SOX are generally working well and provide a fresh audit prospective at a reasonable interval. Rotation on any shorter timeframe would not provide additional benefits and in fact might harm audit quality because the audit firms would likely only be able to comply with such a requirement by auditing clients from remote locations (i.e. Boston partner serves as engagement partner on an LA audit client). This also poses complications with licensing requirements unless a national CPA license is developed. Lengthening time periods a partner can serve a client before rotation could ease the growing problem of partners and their families constantly being asked to move which makes it more difficult for the firms to recruit and develop talent.

- Firm rotation would only work if the rotation period were fairly long (i.e. 15-20 years). Short-term firm rotation (i.e. 5-10 years) would add risk to audit quality. There is a certain amount of "start-up" investment that a firm develops over the first couple of years of an audit. When a firm is in the "start-up" period, audit risk is higher.

III. Complexity in Financial Reporting and the impact on Auditors.

- As a general matter financial reporting has become too complex with too many rules that provide exceptions to broad principles. That being said, one-size-fits-all financial reporting is unworkable. The FASB has assumed all accounting standard setting responsibilities for the U.S. This has resulted in broadly applicable accounting standards that do not adequately consider industry specific concerns. In several cases mutual funds should have unique standards rather than being subject to those of operating companies. Some good recent examples would be FIN 48, the application of FAS 140 to tender offer bonds and mortgage dollar rolls, and FAS 157. While the goals of these standards make sense for corporate America, the value of these standards to the mutual fund community is not as clear. For example, FIN 48 does not adequately contemplate the fact that the tax code and IRS regulation has not kept up with the industry. Widely held tax positions that have little direct support in IRS regulation or the tax code are known and accepted by the IRS staff. There are virtually no IRS audits of mutual funds that occur to provide guidance on accepted positions. This results in a standard that arguably works well for corporate America but is unworkable for the mutual fund industry, causing fund shareholders to pay for financial reporting information that is of little value to them.

- The dissolution of the AICPA as a standard setter has left a void. A return to a similar structure could have significant benefits. The FASB should be considering broad accounting principles that should be followed, but allow for appropriate interpretation within industry segments. The AICPA used to provide that with its structure of industry committees that would consider the principle of a specific standard and determine how best to apply it to the industry. A similar structure could be created by the FASB itself to avoid the prior concerns that the AICPA was overly influenced by the clients of the firms in determining GAAP. The FASB or its staff could select the members of the industry specific committees that would provide consultation to the FASB on broad initiatives and have the ability to issue industry specific guidance. This structure might alleviate some of the recent concerns the standard setting process has created.

- The accounting standards are further complicated by auditing requirements of the PCAOB. When developing accounting pronouncements, the PCAOB and FASB should work in conjunction so the audit impact of the accounting standards are fully considered and addressed before adoption. For example, the implementation of FAS 157 has been made significantly harder on audit firms by suggested audit approaches by the PCAOB.

IV. Audit Market Concentration.

- Concentration is likely a benefit to companies in many industries.

- The concentration allows the firms to have deeper resources in industry specific areas, such as mutual funds, which is a benefit to our shareholders.

- Small firms with fewer resources (i.e. if the Big 4 were required to split up) would actually provide us fewer options. Prior to the wave of consolidation not all of the Big 8 were really capable of handling an audit engagement the size of the American Funds. Concentration has give us 4 firms to choose from that are all capable of handling the fund work. While we might believe certain firms are better than others, we could move the work to the other Big 4 firms and still receive adequate service and competent audits.

V. Human Capital and Its Impact on Audit Quality.

- Human capital is a major concern for audit firms and has an impact on overall audit quality.

- Compensation and work/life balance are the most significant barriers to attracting quality accountants into the profession.

- Increased demand by corporate America for qualified accountants and generally more attractive lifestyles and compensation at corporate America has made it tough for the audit firms to attract and retain quality staff.

- Compensation concerns and work/life balance impacts all ranks in the firms, including partners. A greater number of younger partners are leaving firms for jobs in industry.

- Audit committees and management can have a significant impact on this issue by ensuring that audit firms receive reasonable compensation for audits and by not "squeezing" the audit firms on fees. SOX has helped in this area by requiring the audit committees to set fees, however, management still has significant influence in the process. We try to emphasize level of work and not the total fees when evaluating our audit fees. We stress with the directors that they need to make sure the auditors are spending the right amount of time to perform a quality audit.

- Auditing firms should be required to provide advanced education to more senior professionals. Minimum hours of technical education should be administered by the AICPA including periodic testing of all audit partners.

- Increased attention to ethics training should be required both in university courses and in the audit firms. In addition, the ACIPA or state societies should perform extensive background checks on all CPA applicants.

VI. Human Capital and Its Impact on Audit Quality.

- The failure of another large auditing firm may result in short-term complications, but not long-term risks to the market place.

- Regulators and the Justice Department should not be precluded from bringing charges against a firm that could result in its demise because such a threat provides an appropriate deterrent.

- Regulators and the Justice Department need to have flexibility, however, to address concerns within a firm without causing the entire firm to be dismantled. For example, there were clearly systemic problems with Arthur Andersen (AA), but a better result might have been imposing severe changes in the operating structure of AA instead of taking action that caused the demise of the firm. A number of audit clients were forced to leave AA despite their satisfaction with the local audit team and the audit quality of AA. Most of the AA organization was absorbed by the other firms. We hope that this results in a different more stringent structure instead of the existing structure at AA. Could not the same effect have been accomplished by holding the firm together, but replacing the troublesome parts of the existing firm structure?

Thank you for the opportunity to address these important questions. I look forward to meeting with you on February 4, 2008.

Paul G. Haaga Jr.