June 7, 2021

The Honorable Gary Gensler  
Chair  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549  

Dear Chair Gensler:

The undersigned individuals and organizations share a deep concern about the present state of the financial reporting infrastructure in the United States. Two decades after a wave of major accounting scandals swept U.S. markets and Congress responded with passage of the Sarbanes-Oxley Act (SOX), many of the root causes of that crisis – deeply flawed and outdated accounting standards, weak and ineffective auditor oversight, and auditors who lack both independence and professional skepticism – have reemerged as pressing issues. For too many years, the Commission itself has been either complicit or passive in the face of these developments. We are writing to urge you to take bold action to restore the financial reporting infrastructure on which investor protection, the fair and orderly functioning of our markets, and the efficiency of the capital formation process all depend.

The original federal securities laws are based on a principle that is elegant in its simplicity – that “all investors, whether large institutions or private individuals, should have access to certain basic facts about an investment prior to buying it, and so long as they hold it.”1 As the Alliance of Concerned Investors (AOCI) stated in their April letter, “investors are empowered to make useful investment decisions only when they are provided with robust and timely financial information.”2 Increasingly, there is a growing demand for that information to include applicable disclosures regarding environmental, social and governance (ESG) issues. It’s not just investors, however, but effective market oversight and capital formation, that benefit from the transparency needed to ensure that capital flows efficiently to its best uses. For that system to work, the information that companies report must be complete and accurate. When financial reporting fails to provide the information that investors are demanding, or when investors lose faith in financial reports’ reliability, our markets suffer, as we saw to devastating effect two decades ago.

As you know, the massive accounting scandals at Enron and WorldCom two decades ago revealed the extent to which all aspects of the financial reporting infrastructure had failed. The Financial Accounting Standards Board (FASB) had shown itself to be both glacially slow to update accounting standards and dominated by industry interests when it did act. Auditors who

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1 U.S. Securities and Exchange Commission, About the SEC, What We Do, http://bit.ly/2MngEXy (as the website appeared when accessed August 16, 2019). The wording of these statement has since been revised, but the importance of transparency to informed investment decision-making remains.  
2 Letter from the Alliance of Concerned Investors (Jane B. Adams, Jack Ciesielski, Rebecca McEnally, Janet Pegg, and Lynn Turner) to SEC Chair Gary Gensler et. al. (Apr. 19, 2021). (AOCI Gensler Letter)
were exempt from both independent regulatory oversight and, after the passage of the Private Securities Litigation Reform Act, legal accountability, too often reflected that lack of accountability in their lax audits. And, thanks to political interference from members of Congress, even the SEC, which had sought to improve auditor independence, had been forced to adopt auditor independence rules that were significantly weaker than originally proposed. As a result, audits of public companies in the Enron era fell well short of the true independence and professional skepticism upon which their credibility depends.

SOX sought to address those failings through a comprehensive approach that included measures to improve the governance of FASB, increase the independence of public company audits, strengthen the regulatory oversight of auditors, make corporate managers more accountable for the accuracy of their financial reporting, and more. From the outset, however, SOX was hampered by weak implementation by an SEC that, too often, appeared to take its cues from the large accounting firms, rather than focusing on the needs of investors. The governance and funding reforms put in place at FASB were insufficient to counteract the dominance the auditing and issuer community were able to exert over the standard-setting process through their majority representation on the board. The Public Company Accounting Oversight Board (PCAOB), which got off to a rocky start, was never given the pro-investor majority it needed to fulfill its mission during the Obama Administration and was decimated by leadership openly antagonistic to its mission during the Trump Administration.3

The result is that, today, FASB remains both glacially slow and unresponsive to investor concerns, and the PCAOB seems to have become more focused on protecting audit firms than protecting investors. For example, although its inspectors have repeatedly found that public company auditors lack independence and professional skepticism, it has failed to take any meaningful action to address that problem.4 Instead, the PCAOB has advanced an agenda in recent years that weakens auditor independence rules and auditor oversight alike. Instead of prodding these independent agencies to protect investors, the SEC, through its Office of the Chief Accountant (OCA), has aided and abetted their abandonment of their investor protection mission, undermining reform efforts and weakening auditor independence rules.5

As a result of these institutional failures, we are recreating the conditions that led to the massive wave of accounting scandals that rocked the markets two decades ago. It will take bold action now to reverse that degradation of the financial reporting infrastructure, and to do so before we see catastrophic results resembling those of the Enron area. This letter outlines the areas that we view as being high priorities for action. They include:

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5 Id.
- Reconstituting FASB and the Financial Accounting Foundation to include a majority of investor members with expertise in the use of financial reports and knowledge of the accounting standard-setting process.
- Undertaking a top-to-bottom housecleaning at the PCAOB, including changing its leadership, increasing its budget, restoring the expertise of its staff, increasing the frequency and rigor of inspections and backing them up with strong enforcement, and reinvigorating the standard-setting process.
- Appointing investor representatives as Chief and Deputy Chief Accountants in order to refocus that office on its investor protection mission.

The following explains each of these recommendations, and the reasons behind them, in greater detail.

Reforming FASB

Reliable financial reporting starts with sound accounting standards that, when properly implemented, provide investors with a complete, comparable, and accurate picture of a company’s financial condition. Since 1972 it has been the responsibility of FASB to write the Generally Accepted Accounting Principles most public companies are required to use when preparing their financial statements. Before FASB was created, this function was carried out by the Accounting Principles Board, a committee of CPAs working on a voluntary, part-time basis. The goal of transferring this responsibility to FASB – a full-time board with a more broadly representative make-up – was to “attain better results faster.”

The massive accounting scandals at Enron and WorldCom revealed how far short of this ideal FASB had fallen. As former SEC Chairman Arthur Levitt stated in congressional testimony in the wake of the Enron failure, FASB had failed to keep pace with changing business practices, with the result that investors had not been given a clear picture of the company’s declining financial condition. “Because the Financial Accounting Standards Board is funded and overseen by accounting firms and their clients, its decisions are agonizingly slow,” he testified. Former SEC Chair Richard C. Breeden generally agreed with Levitt’s diagnosis, stating that, “we have to work carefully to make sure that the SEC has enough clout with the FASB and that the FASB has enough independence to do its job well. But the standard setting process has to involve faster action, more relevant principles, and principles designed to protect accuracy.”

While SOX included provisions to strengthen the independence of FASB’s funding and governance, the same long-standing complaints about the accounting standard-setting process remain today. In particular, investors continue to voice concerns that the board is both slow and

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dominated by auditors and corporate finance executives, who hold a majority of seats on the board.\textsuperscript{9} That industry dominance is reflected in the agenda and output of the board, a problem that has become particularly acute in recent years. As the Alliance of Concerned Investors explained in an October 2020 letter, “investors have been ignored in the agenda-setting process” of FASB. Instead of focusing on issues of concern to investors, the board has “focused significant time and resources on ‘simplification’ projects that appear to benefit and provide relief to preparers and their auditors rather than investors. Indeed, the efforts of the FASB have been spent on reducing information provided to investors, thus facilitating development of an environment in which investors are less informed.”\textsuperscript{10} In short, nearly 50 years after its creation, and despite efforts at reform, FASB has never achieved its full potential and now shows signs of being “an entity in decline.”\textsuperscript{11} This evidence of decline takes on added urgency if, as some propose, FASB and its oversight board, the Financial Accounting Foundation (FAF), are given a greater role in the writing of ESG-related accounting standards.

We agree with those who have suggested that the root cause of FASB’s problems is the lack of adequate investor representation on both FASB and the FAF. As the Alliance of Concerned Investors noted in its October 2020 letter, “it is investors whose decision-making process is dependent on publicly released financial information as the primary source of company performance,” and their perspective should therefore dominate both FASB and FAF.\textsuperscript{12} Regulators and other stakeholders also depend on complete and accurate financial statements. But, at these entities dominated by preparers and auditors, according to AOCI, “the focus has shifted from what investors need to know to make informed decisions to an exercise where gatekeepers limit and control the amount of information preparers and auditors find it acceptable to release to investors.”

In order to restore investor confidence in the work of the FASB, investor representation on both FASB and FAF should be increased to a majority. The individuals chosen to fill these investor slots should have an understanding of and extensive experience using financial reports and disclosures prepared in accordance with GAAP, a commitment to transparent financial reports necessary for investors to make informed investment decisions, significant familiarity with the accounting standard-setting process, and a record of serving the interests of investors and the public. Only if FASB and FAF are reformed to include more robust investor representation can we reasonably expect these boards to reflect investors’ perspectives.

At the same time, we believe the time has come for a new, comprehensive study of the accounting standard-setting process by an independent, expert panel. It has been almost 50 years since the last such review was conducted to increase the efficiency of, and investor confidence in, accounting standards.\textsuperscript{13} Despite the reforms adopted in the wake of that study, and the steps taken by Congress in SOX to increase FASB’s independence, problems with the slow pace and

\begin{itemize}
  \item \textsuperscript{9} AOCI Gensler Letter.
  \item \textsuperscript{10} Letter from the Alliance of Concerned Investors (Jane B. Adams, Jack Ciesielski, Rebecca McEnally, Janet Pegg, and Lynn Turner) to SEC Chair Jay Clayton et. al. (Oct. 26, 2020). (AOCI Clayton Letter) (The letter notes that this problem is exacerbated by the fact that FAF has ceded to FASB responsibility for post-implementation review of accounting standards, thereby putting FASB in charge of overseeing its own work.)
  \item \textsuperscript{11} AOCI Gensler Letter.
  \item \textsuperscript{12} Id.
  \item \textsuperscript{13} Wheat Report.
\end{itemize}
lack of investor focus in the work of FASB persist. Moreover, standard-setting now faces a new challenge, in the form of demands for increased disclosure of climate change and other ESG factors. A broadly representative expert commission could conduct a thorough examination of these issues and make recommendations to the Commission on how best to address these concerns.

In order to reinforce these reforms, the SEC Office of Chief Accountant should exert its oversight responsibility to keep FASB and its agenda focused on its investor protection mission. For that to happen, however, the SEC’s OCA will itself need a make-over, as we discuss further below.

**Reforming the PCAOB**

Within the financial reporting infrastructure, auditors are the gatekeepers responsible for ensuring that financial statements are prepared and fairly presented in accordance with GAAP. But in an issuer pays business model, where auditors are hired and fired by the companies whose financial statements they audit, independence is an illusion and operating with the appropriate degree of professional skepticism can come with a heavy price. In the wake of the spectacular audit failures at Enron, WorldCom and a host of other public companies, Congress sought to address this problem, in part, by creating the PCAOB to police the audit profession. As former SEC Chairman Levitt has explained in a recent opinion piece, this relatively obscure board carries “an awesome responsibility” on which the integrity of our financial system depends – “to bring some measure of accountability to a profession whose work is not only at the core of our free market system but also requires oversight and correction.”

Unfortunately, the Board, which has been plagued by scandal periodically throughout its history, was simultaneously politicized and decimated in the previous administration. As detailed in a recent letter from former members of the PCAOB’s Investor Advisory Committee (IAG), the recent degradation of the PCAOB started with the replacement of the entire Board in 2017, with only one of the newly appointed members having a record of advocating on behalf of investors. The new Board immediately instituted a massive change in staff leadership as well,

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14 This letter was written and circulated for sign-on before last week’s announcement that William D. Duhnke III had been removed as Chair of the PCAOB. (SEC Press Release, SEC Announces Removal of William D. Duhnke III from the Public Company Accounting Oversight Board; Duane M. DesParte to Serve as Acting Chair (Jun. 4, 2021), [https://www.sec.gov/news/press-release/2021-93](https://www.sec.gov/news/press-release/2021-93).)


ousting dozens of long-serving PCAOB managers, including each of the heads of the Board’s four primary divisions (Standards, Registration and Reporting, Inspections, and Enforcement), along with the General Counsel, Chief Auditor, and Director of Information Technology. As the former PCAOB IAG members explained in their letter, “Discharging such personnel has undermined the Board’s ability to serve its purpose, and to do so with the expertise investors need.”

Having decimated the staff, the Board next set about reducing its budget, including for its critically important inspection function. As a result, “constraints on the PCAOB’s budget have significantly hampered the Board’s ability to revamp its old interim auditing and quality control standards, inspect the audits of each of the largest public companies on a realistic timetable, and take timely, transparent enforcement actions.” The Board simultaneously adopted a new Strategic Plan, which barely mentions either investor protection or enforcement, weakened inspection requirements, and “deemphasized diversity when compared to the PCAOB’s prior strategic plan.” The Board also ceased meeting with its duly appointed advisory groups, including both the Standing Advisory Group and the IAG, adopted policy changes weakening auditor independence policies without soliciting public comment, ceased holding roundtables to provide for open, public debate on important policies, and failed to hold regular Board meetings or to make its meeting agendas public.

This recent assault by Board leadership on the integrity of the PCAOB comes on the heels of a decades-long failure of the Board to effectively carry out its independent standard-setting function. Instead of setting tough new standards, as it was authorized by Congress to do, the PCAOB has continued to rely on holdover interim standards written by AICPA before PCAOB was created. As the former IAG members noted in their letter, “These standards were written in an era of flawed self-regulation that failed to prioritize the interests of investors and the public.” In fact, these are in many cases the same standards that “contributed to the failed audits of companies such as Enron.” Meanwhile, it has failed to “act on recommendations from investors with respect to significant auditing standards in need of reform, such as standards for disclosure of audit quality metrics, auditing non-compliance with laws and regulations, going concern audit opinions, and the need for auditor involvement with other information in filings with the SEC such as disclosures of the impact of climate change and Non-GAAP measures.”

Nothing short of a top-to-bottom overhaul of the PCAOB will serve to restore this agency to its investor protection role, and that will require new membership on the Board with both deep expertise and a commitment to serving the investing public. As a first step, we urge you to act quickly to appoint a replacement for recently departed Board Member J. Robert Brown. The individual chosen to fill this vacancy should immediately be designated as Board chair. But that is just the first step. With the Board once again mired in scandal, more sweeping changes to

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18 Id.
19 Id.
20 Id.
22 Id.
23 Id.
Board Membership are needed to restore public confidence in the Board’s integrity and its commitment to its investor protection mission. Moreover, you must not repeat the mistakes of the Obama Administration, when the Board Chair was never given the support necessary to move a pro-investor agenda.

Once the leadership of PCAOB has been changed, the SEC Office of Chief Accountant must work with the agency and the Commission to restore the PCAOB’s budget, to install high-level staff with the experience and commitment to the public interest necessary to the job, and to refocus the Board on increasing the frequency and rigor of inspections, backing them up with strong enforcement, and reinvigorating the standard-setting process to focus on audit standards that have been identified by investors as priorities for revision and updating.

Reforming the Office of Chief Accountant

Bringing about these necessary changes at FASB and PCAOB will require strong leadership from the Office of Chief Accountant (OCA) at the SEC. As the SEC website explains, OCA “is responsible for accounting and auditing matters arising in the Commission’s administration of the federal securities laws, particularly with respect to accounting policy determinations, the form and content of financial statements to be filed with the Commission, and internal control over financial reporting (ICFR) matters.” The Chief Accountant also serves as “the principal adviser to the Commission on matters related to accounting and auditing.” As such, OCA plays a critically important role overseeing the financial reporting system in the United States. For example:

- It oversees both FASB and the International Accounting Standards Board (“IASB”) in setting the financial reporting standards used by registrants in the preparation of their financial statements. In that role, it both requests that these standard setters undertake new standard-setting projects when existing standards are in need of an update and provides input to FASB and IASB as standards are being developed. The SEC also has the authority, pursuant to SOX, to set new standards itself when the FASB or IASB fail to provide necessary transparency for investors.
- It plays a similar role in the oversight of PCAOB as it sets and enforces auditing standards. Indeed, the Commission has over the years delegated much of its oversight responsibility with regard to PCAOB to the Chief Accountant, including responsibility for setting the annual budget of the PCAOB. Yet the senior leadership of OCA in the past dozen years or more has come from the national offices of the same auditing firms subject to PCAOB and SEC oversight.
- OCA also interacts on a daily basis with registrants and their auditors regarding the proper implementation and application of accounting, auditing, and disclosure policies.

In short, OCA bears considerable responsibility for ensuring that the financial reporting system functions as intended to provide investors with complete, comparable, and reliable information on which to base their investment decisions.

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For the financial reporting system to perform as intended, OCA must perform its functions in a way that advances the Commission’s mission of protecting investors, promoting fair and orderly markets, and promoting capital formation. While many parties have a stake in the accuracy of financial reporting, investor concerns should weigh particularly heavily in its approach to that mission. As the SEC’s Advisory Committee on Improvements to Financial Reporting noted in its 2008 final report, investors are the “primary consumers of financial reports.” According to the SEC’s Advisory Committee on Improvements to Financial Reporting, investors’ perspectives should be given preeminence in the development of financial accounting and reporting policies. Instead, OCA has too often reflected the interests of accountants, particularly the large accounting firms, rather than investors. One likely cause – every Chief Accountant since SOX was passed has come from the Big Four accounting firms, and many members of OCA staff. And all too often, the Chief and Deputy Chief accountants have passed back through the revolving door to their former firms, an obvious and serious conflict.

While accounting expertise is essential to the job, the ability of the Big Four firms to dominate the OCA in this manner has clearly colored its approach to its responsibilities and impaired its ability or its willingness to keep investors’ interests at the forefront in performing its responsibilities. As a result, instead of correcting the bias toward industry at FASB and PCAOB, OCA has reinforced and intensified that bias. Indeed, when previous leaders at PCAOB sought to rein in audit industry abuses, OCA worked to impede, rather than support, those efforts. The OCA has also used its oversight responsibility to cut the PCAOB’s budget, including with regard to its key responsibility of audit inspection. When the PCAOB suspended meetings of its advisory committees, including the statutorily mandated Standing Advisory Group, the OCA did nothing to intervene. Similarly, it has failed to use its influence with FASB to encourage the Board to take up the accounting issues identified by investors as high priorities.

If we are to restore the financial reporting infrastructure, the OCA’s long history of advocating industry, rather than investor, interests must come to an end. In this regard, we agree with the Council of Institutional Investors (CII), which stated in an April letter, the Chief Accountant will be more likely to have “a deep understanding and appreciation for the needs of investors” if “a qualified investor or investor representative” is chosen to lead the Office of Chief Accountant. We would add that a similar focus on the needs of investors should be reflected in other senior personnel within the office. Moreover, we agree with CII that, “This goal is particularly timely and appropriate given the interest by investors in sustainability reporting and its interrelationship with financial accounting and reporting.”


26 Paul Munter (KPMG), Sagar Teotia (Deloitte), Wes Bricker (PriceWaterhouse Cooper), James Schnurr (Deloitte), Paul Beswick (Ernst & Young), James L. Kroeker (Deloitte), Conrad Hewitt (E&Y), Donald Nicolaensen (PwC), Jackson Day (acting, E&Y)
29 Id.
priorities uppermost as you select your Chief Accountant and fill other senior positions in that office.

**Conclusion**

Market integrity, investor confidence, and the efficient allocation of capital all depend on complete, accurate, and comparable financial reporting. Currently, however, the institutions that make up the financial reporting infrastructure – FASB, PCAOB, and the SEC Office of Chief Accountant – are in a state of serious disrepair. This poses a grave risk to the transparency, integrity, and orderly functioning of our markets. It is all the more pressing as the Commission considers how best to respond to the unmet demand from investors and other important market stakeholders for better information about climate change and other ESG factors. We look forward to working with you to restore these entities to their appropriate role of ensuring that financial reports are complete, accurate, and comparable – to the benefit of investors, the markets, and the health of our economy.

Respectfully submitted,

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Member, Alliance of Concerned Investors

Eleanor Bloxham, CEO
The Value Alliance

Dana Chasin, Principal
20/20 Vision

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Robert A. Conway, Former PCAOB Regional Office Leader and Author of *The Truth About Public Accounting*

James D. Cox, Brainerd Currie Professor of Law
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Lawrence A. Cunningham, Henry St. George Tucker III Research Professor
George Washington University

Lisa Donner, Executive Director
Americans for Financial Reform Education Fund
Maria Demetra Egan, Vice President.
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Parveen P. Gupta, Clayton Distinguished Professor of Accounting, Lehigh University
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Linda Sherry, Director, National Priorities Consumer Action

Steve Suppan, Senior Policy Analyst
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Katherine Venice, CFA MBA, Founder
The Ethical Capitalism Group

Dieter Waizenegger, Executive Director
CtW Investment Group
Josh Zinner, Chief Executive Officer
Interfaith Center on Corporate Responsibility

Cc: The Honorable Hester M. Peirce, Commissioner, U.S. Securities and Exchange Commission
The Honorable Elad L. Roisman, Commissioner, U.S. Securities and Exchange Commission
The Honorable Allison Herren Lee, Commissioner, U.S. Securities and Exchange Commission
The Honorable Caroline A. Crenshaw, Commissioner, U.S. Securities and Exchange Commission
The Honorable Sherrod Brown, Chairman, Committee on Banking, Housing and Urban Affairs, U.S. Senate
The Honorable Patrick J. Toomey, Ranking Member, Committee on Banking, Housing, and Urban Affairs, U.S. Senate
The Honorable Robert Menendez, Chairman, Securities, Insurance and Investment Subcommittee, U.S. Senate
The Honorable Tim Scott, Ranking Member, Securities, Insurance and Investment Subcommittee, U.S. Senate
The Honorable Maxine Waters, Chairwoman, Financial Services Committee, U.S. House of Representatives
The Honorable Patrick McHenry, Ranking Member, Financial Services Committee, U.S. House of Representatives
The Honorable Brad Sherman, Chair, Subcommittee on Investor Protection, Entrepreneurship and Capital Markets, U.S. House of Representatives
The Honorable Bill Huizenga, Ranking Member, Subcommittee on Investor Protection, Entrepreneurship and Capital Markets, U.S. House of Representatives