



American Institute of CPAs  
1455 Pennsylvania Avenue, NW  
Washington, DC 20004-1081

**WRITTEN TESTIMONY OF BARRY C. MELANCON, CPA  
ON BEHALF OF THE  
AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS**

**BEFORE THE  
SUBCOMMITTEE ON CAPITAL MARKETS  
AND GOVERNMENT SPONSORED ENTERPRISES  
HOUSE FINANCIAL SERVICES COMMITTEE  
U.S. HOUSE OF REPRESENTATIVES**

**HEARING ON ACCOUNTING AND AUDITING OVERSIGHT:  
PENDING PROPOSALS AND EMERGING ISSUES CONFRONTING  
REGULATORS, STANDARDS SETTERS AND THE ECONOMY**

**March 28, 2012**

**AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS**

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BARRY C. MELANCON, PRESIDENT AND CEO  
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Good morning Chairman Garrett, Ranking Member Waters and members of the Subcommittee. My name is Barry Melancon and I am a CPA and president and CEO of the American Institute of Certified Public Accountants (“AICPA”). I am pleased to be able to testify before you today about “Accounting and Auditing Oversight: Pending Proposals and Emerging Issues Confronting Regulators, Standards Setters and the Economy.” I will address the CPA profession’s commitment to the public interest, as well as the important services CPAs provide to U.S. businesses of all sizes and to investors and the profession’s role in the global economy and global capital markets.

This year, the AICPA celebrates its 125<sup>th</sup> anniversary. The AICPA was established by the accounting profession to serve the public interest by fostering independence, objectivity and competence, the highest possible level of professionalism and ethical behavior. Our mission is to provide our members with leadership, information and resources to enable them to provide valuable services in the highest professional manner to benefit the public, employers, investors and clients.

The world was very different in 1887 when the AICPA began than it is today. Businesses were simpler entities that focused on local markets and customers. Financial instruments were limited to hard currency and paper checks. And the Securities and Exchange Commission (“SEC”) would not be established for another 47 years.

It’s not an exaggeration to say that virtually everything CPAs do and how they do it has changed since then; the capital markets and business activity around the

globe have become more complex. What has not changed, however, is the commitment the AICPA and the profession made in 1887 to ensure the highest levels of quality and professionalism, unimpeachable ethics, objectivity and a healthy degree of skepticism, and financial reporting and auditing that meets the investment community's need for transparency and expert analysis.

The AICPA is the world's largest association representing the accounting profession, with nearly 377,000 members. AICPA members represent many areas of practice, including business and industry, public practice, government, education and consulting. CPAs work in accounting firms that range from sole proprietors in small towns supporting Main Street businesses, to large firms with thousands of employees supporting multinational entities with operations worldwide. CPAs are business owners, CEOs and CFOs and serve in other key decision-making roles in companies, from the Fortune 100 to small businesses, throughout America.

The AICPA sets ethical standards for the profession and U.S. auditing standards for audits of private companies, non-profit organizations and federal, state and local governments. It develops and grades the Uniform CPA Examination and offers specialty credentials for CPAs who concentrate on personal financial planning; fraud and forensics; business valuation; and information technology.

The AICPA works to ensure that CPAs have the skills, tools and information necessary to address the complicated accounting, tax and auditing questions they face every day. Our members are required to exercise sound professional judgment as they practice, regardless of whether the beneficiary will be investors, lenders, employers, employees, taxpayers or an unknown third party.

Of critical importance to the AICPA is that the profession fulfills its commitment to lead as our business community, its financial reporting needs and the needs of investors and other users of business information continue to evolve in a rapidly changing environment.

To that end, we've identified five strategic initiatives where we devote significant resources toward the advancement of the profession. We believe it is critical to create an environment that attracts the best and brightest from each generation to join and remain in the profession, to assure the quality of the services performed and to promote innovation for the future.

The first strategic initiative is attracting and retaining the best and the brightest people into the profession.

The CPA profession recognizes its principal asset is human capital and the AICPA is making significant investments in creating a vibrant and highly qualified supply. Our research tells us that the baby boomer generation will be retiring at an alarmingly high rate, over 10,000 every day for the next 19 years, and that professions will be competing with each other to attract the best and the brightest. Our goal is to create an environment where the millennial generation is attracted to and continues to see the accounting profession as a rewarding profession where individuals can collectively make a difference in their communities, businesses and the economy.

The AICPA engages students through our **Start Here, Go Places** website, which is focused on high school and community college students. The site allows students to explore broad possibilities from small business start-ups to Fortune 100 companies.

We know that enrollment at community colleges is reaching an unprecedented level, but resources available to accomplish a transfer to a four-year institution continue to be challenged. To serve these needs, the AICPA, in partnership with other associations and state CPA societies, has taken critical steps to help students and educators at two-year colleges enhance the pathway to four-year schools.

To continue providing university accounting students and CPA candidates with a clear roadmap to navigate the educational and licensure process and become successful CPAs, the AICPA launched its community-based website, **ThisWayToCPA.com**. Since the website's launch, more than 27,800 have joined this community, which features CPA role model profiles, recent CPA candidate exam diaries and state licensure requirements.

**ThisWayToCPA.com** hosts scholarship applications and the **Legacy Scholars Program**. About 80 percent of the 2011 - 2012 class of AICPA Legacy Scholars represents students from ethnically diverse backgrounds. During the fall semester, Legacy Scholars' community service and outreach efforts reached over 4,600 individuals.

Because we believe there is an impending shortage of accounting PhD faculty, which are a necessary and integral part of the accounting profession supply chain, the AICPA established the **Accounting Doctoral Scholars Program**. With financial commitments exceeding \$17 million, the program's goal is to increase the current

doctoral pool by 120 PhDs by 2016. This program should also increase the availability and quality of accounting programs across the country.

The AICPA has established the **Fellowship for Minority Doctoral Students** to ensure that PhDs from minority populations are provided the resources to participate as we work toward creating a more ethnically diverse profession. Recognizing the need for ethnically diverse role models, the AICPA is enhancing its focus on diversity under the newly established **AICPA National Commission on Diversity**.

Aligning with the recommendations of the **Advisory Committee on the Accounting Profession for the US Treasury Department**, the AICPA works to address the future of accounting education through the efforts of the Pathways Commission. The Commission's goal is to provide ongoing strategies to enrich accounting education processes. The AICPA stands ready to support and implement the forthcoming recommendations.

The second initiative is ensuring the ongoing competency of the best and the brightest in their respective roles.

What may be most familiar to the Subcommittee is the fact that the AICPA develops and maintains the **Uniform CPA Examination** ("Examination"), which establishes the entry point for CPAs into the profession and is designed to assure a competency baseline for the best and the brightest. Examination content development is a major AICPA effort, involving sixty full-time AICPA staff and hundreds of CPA volunteers who spend literally thousands of hours every year on the development of new examination questions. A constant flow of new questions is necessary to maintain the currency, vitality, and credibility of the CPA Examination – which remains a critical entry point for professionals who serve the public in a wide swath of roles, from the CFO to the auditor to the tax preparer.

CPAs serve in many key decision-making roles, including those who work in business and industry. For example, over 42 percent of our members practice as management accountants—those CPAs on the front line every day making decisions about their businesses. Management is responsible for the preparation of financial information and therefore a CPA in business or industry is the gatekeeper who is responsible for the preparation of high quality financial statements. It is critical that CPAs have the skills and tools to "get it right." This includes a steady moral compass, a healthy eye for skepticism, the knowledge to apply professional judgment, and the technical accounting resources to apply his or her craft, including enhanced understanding of financial reporting standards. The AICPA's role is to

provide the ethical framework, training and guidance so that the preparer is best positioned to “get it right.” We do this through the development and issuance of training materials (e.g., conferences, continuing education) and publications (e.g., industry accounting guides, checklists, comparison tools).

The auditor provides an opinion on financial statements that are the responsibility of management to prepare. Auditing involves complex procedures designed to provide the auditor with sufficient evidence so that the auditor has reasonable assurance, which is a high but not absolute level of assurance, that his or her opinion is correct.

CPA firms and the AICPA commit significant resources to training and educating auditors in order to “get it right.” Examples of our areas of focus are training and guidance materials in auditing standards and audit methodology, the development of skills necessary for fraud detection and how to apply professional skepticism and judgment and education in unique industries and areas of specialization, such as auditing fair value calculations or testing information technology controls.

One of the keys to quality is the structure that firms have in place to internally support and monitor their audit engagement teams. For example, the major accounting firms and the AICPA provide practitioners with access to specialists in accounting and auditing on a daily basis. These consultations help promote accounting and audit effectiveness as well as consistency in the application of standards. Internal review, monitoring and inspection of audit engagements are also key components of assuring that the firm has complied with all appropriate professional standards.

Further, external quality monitoring via peer review and Public Company Accounting Oversight Board (“PCAOB”) inspection provide the final layer of oversight, designed to provide investors with confidence that the auditor has the skills, education and procedures in place to assure that the audit meets the appropriate professional standards and can be relied upon.

As part of the AICPA’s commitment to audit quality, we have established audit quality centers, so that we can provide CPAs with focused tools and resources to meet the ongoing challenges of a vibrant and changing environment. Our **Governmental and Employee Benefit Plan Audit Quality Centers** focus on enhancing the performance of the CPA firms that audit the many thousands of entities that receive federal assistance, including governments, not-for-profits and certain for-profits and that participate in over 80,000 employee benefit plans, such as 401(k), pension and health and welfare plans subject to the Employee Retirement Income Security Act.

In addition, five years ago the public company auditing profession established the **Center for Audit Quality**--an independent organization affiliated with the AICPA, whose sole mission is to improve the quality of and confidence in public company audits--which has been a leader in the profession, dedicated to enhancing investor confidence and public trust in the global capital markets.

Third, the AICPA promotes independent, relevant financial reporting, auditing, and ethical standards.

Standards of practice, developed free of any special interest influences but with input from all relevant stakeholders, are critical to the production of information that is meaningful to investors and other users of business information.

Accordingly, the AICPA supports the ongoing independence of the Financial Accounting Standards Board ("FASB") in its activities to develop financial reporting standards for public companies. More broadly, we support the development of one set of high quality global financial reporting standards, and we believe that International Financial Reporting Standards--or IFRS--are best positioned to be that set of standards. The accounting profession strongly encourages the SEC to make a decision soon on next steps with respect to IFRS incorporation into U.S. GAAP.

The AICPA was an early supporter of international convergence of accounting standards and has fully supported the incorporation of IFRS into the U.S. financial reporting framework. There is no choice: uniform international standards are critical. Multinational companies are chartered in different countries and the AICPA is convinced that investors will benefit if issuers around the world prepare financial statements using a common set of high quality, globally accepted and consistently applied and enforced financial reporting standards.

Along these lines, we would also suggest the PCAOB consider utilizing International Standards on Auditing--ISA--as a basis for U.S. public company auditing standards.

Finally, the AICPA's mission includes promoting the highest possible ethical standards. It sanctions members who do not follow the standards that we have set and that we believe are essential to the proper professional performance of a CPA.

The fourth strategic initiative is developing and implementing innovative solutions to the increasingly complex issues and business environment that CPAs navigate skillfully for their clients and employers.

Accounting and auditing solutions need to keep pace with business activities in order to maximize the ability of the profession to provide value-added services. Standards for financial reporting are critical to the equation and non-financial information is becoming an increasingly integral tool to assess current and future business performance. Measurement of natural resource use and replenishment is a good example of the kind of issue the profession is confronting.

How these important measures are reported and whether there should be independent reporting and assurance on those measures is an emerging discussion topic within the business community.

Internal control has always been an integral part of reliable financial reporting, and Sarbanes-Oxley focused renewed attention on its importance. We believe that robust internal control over financial reporting is critical to every organization, regardless of size. Further, testing financial reporting control effectiveness and reporting on controls to some extent should be required in every audit. The AICPA continues to believe that there should be no additional exemption for existing issuers from section 404(b) of Sarbanes-Oxley.

Use of technology is a given and it is one of the critical tools companies utilize to manage their businesses. We believe it is important for users of business data to have meaningful and usable information to help them make investing decisions. While not demanded yet, we believe that users will seek a common format on the source data that ultimately results from financial statements and we are on the frontlines to support the advancement of such a format.

**EX**tensible **B**usiness **R**eporting **L**anguage (“XBRL”) is an electronic data format standard that is already opening doors by allowing users of financial information to drill down into financial statements and other business reports. XBRL is a royalty-free, international information format designed specifically for these purposes, which allows users to automatically consume and analyze the data. We strongly believe the broader application of the XBRL data standard across reporting streams would create tremendous efficiency gains and enable more sophisticated and timely analysis. The creation of new tools to leverage these data standards will magnify this potential exponentially.



Looking to the future, the AICPA and the profession are working to integrate key non-financial data with financial reporting measures to provide one integrated meaningful report. We started this work nearly 10 years ago with the creation of the **Enhanced Business Reporting Consortium** and are now collaborating with the **World Intellectual Capital Initiative** and the **International Integrated Reporting Council** to advance this initiative.

We are also looking at the best ways to develop assurance of this data via activities related to data standards, information integrity and system reliability which addresses the privacy, security and confidentiality of information in addition to other criteria.

Finally, we recognize that preventing and detecting fraud remains a significant challenge for all members of the “financial reporting supply chain”—company management, boards of directors, audit committees, internal auditors and external auditors. While company management has primary responsibility when it comes to preventing and detecting fraud and the financial statement audit is designed to provide reasonable assurance that material fraud will be detected, all members of the supply chain should work together to leverage their complementary and interconnected duties. Of great importance in mitigating the conditions leading to fraud is the tone at the top, skepticism and strong communication. A critical part of the profession’s work, headed by the Center for Audit Quality, is the formation of an **Anti-Fraud Collaborative Partnership** with a number of other financial associations. The partnership is engaged in a number of projects aimed at improving our collective ability to deter and detect financial reporting fraud.

The fifth strategic initiative is supporting robust but balanced regulation.

Robust, balanced regulation is the final component of the strategic equation.

The profession is subject to several layers of regulation. State boards license and regulate CPAs at the state level. Several agencies regulate CPAs at the federal level depending on the area of practice, including the SEC and the PCAOB.

The AICPA believes in a strong and balanced regulator for the public company audit profession and supports robust regulation of the profession in a manner that protects the public, but does not detract from, nor negatively impact, quality

reporting and auditing and does not restrict the effective and efficient flow of capital.

There are several current issues that should be noted in a discussion of robust and balanced regulation:

1. A strong and balanced regulator for the public company audit profession. The AICPA and the profession communicate regularly with the SEC, PCAOB, FASB and Governmental Accounting Standards Board (“GASB”) to provide useful and relevant information about the profession and to make sure that the profession’s views are considered as part of these organizations’ deliberations. Through our members’ expertise and the information and data we have compiled, we formally comment on proposals and informally consult with these entities, to help them fully understand the implications of what they are considering and ultimately develop meaningful and balanced regulation and standards.

During its entire history, the AICPA has consistently worked closely with Members of Congress, regulators, the accounting standards-setting bodies and ad hoc federal task forces and committees, to assure balanced regulation of the profession.

2. PCAOB Rulemaking. The PCAOB is currently engaged in a number of projects and is to be commended for the manner in which it is approaching them. For example, before issuing the concept release on possible changes to the auditor’s reporting model, the PCAOB held open forums as well as private meetings with a wide variety of stakeholders, including auditors, audit committee members and investors, to help shape the ideas presented in the concept release. This is a good example of how a strong and balanced regulator acts to promote the public interest.

3. PCAOB Concept Release on Firm Rotation. In August 2011, the PCAOB issued Release No. 2011-006--*Concept Release on Auditor Independence and Audit Firm Rotation*—focusing on various recommendations, including the periodic, mandatory rotation of an audit firm, to improve auditor independence, objectivity and skepticism. Sarbanes-Oxley delegated responsibility for overseeing the financial reporting process, including the hiring and firing of the external auditor, to independent audit committees. Audit committees, which take this responsibility seriously and have the requisite skills, fiduciary knowledge and experience, are the appropriate and balanced approach to the auditor’s ongoing engagement and retention. We believe in the audit committee’s authority and support efforts to strengthen the role of the audit committee, not undermine it.

Interestingly, the PCAOB's release acknowledges that there is little evidence linking audit firm tenure to audit failures or a lack of independence, objectivity and professional skepticism by the auditors. The release also recognizes that mandatory audit firm rotation would represent a significant change in practice and would increase costs and cause disruptions for companies and external auditors.

Of the roughly 600 comment letters received by the PCAOB, 94 percent were against mandatory audit firm rotation, including that of the Government Accountability Office ("GAO"), which stated the PCAOB "does not provide compelling evidence that the root cause of the audit quality issues [it has found] is related to a breakdown in auditor independence." GAO also stated, "Even if the PCAOB could clearly establish that a lack of independence or objectivity is causing audit quality problems, it is unclear that such a problem would be prevented or mitigated by a mandatory audit firm rotation requirement." Finally, it's important to note that more than 200 letters were sent to the PCAOB by audit committees during the original comment period, and not one supported rotation.

Given the significant costs and disruption, the lack of evidence linking engagement tenure to audit quality, and, most importantly, the risk that mandatory rotation is actually a detriment to audit quality, we oppose mandatory firm rotation. We do however support the review underway to further enhance both the role of the auditor and of the audit committee in ways that enhance the quality of information provided to investors. We believe this is a much more beneficial and fruitful area on which to focus.

Should the PCAOB's Concept Release become a proposal which is adopted, it would represent a very clear example of unbalanced regulation. It would impose significant strains on the audit profession and the public company business community with no evidence that the Sarbanes-Oxley formula, which assigned authority to hire and fire the auditor to the independent audit committee, is not working in a way that protects the public interest.

4. Transparency of PCAOB Enforcement Proceedings. The PCAOB also has urged Congress to amend Sarbanes-Oxley and make its enforcement proceedings public. To that end, the "PCAOB Enforcement Transparency Act of 2011," which has been introduced in both the House and the Senate, would

make PCAOB hearings and all related notices, orders, and motions, open and available to the public unless otherwise ordered by the Board.

PCAOB enforcement proceedings currently are confidential under Sarbanes-Oxley, because Congress understood that auditors belong to a profession in which a good reputation is essential and publication of *unproven* charges may end an individual auditor's career or audit firm's existence. Congress created a special confidentiality regime for PCAOB enforcement proceedings because of that concern and because the PCAOB is not part of the government and thus is not subject to the procedural due process requirements imposed on government agencies pursuant to the Administrative Procedures Act.

Most assuredly, the AICPA and the accounting profession want to eliminate bad actors from the profession. The stain from one affects all. But there needs to be an appropriate balance of the rights of the accused and due process for someone unjustly accused.

Transparency of PCAOB disciplinary matters is appropriately addressed under current law, by the PCAOB's authority to refer matters to the SEC when it determines that public disclosure is necessary to protect the public interest. The SEC has the authority to make its investigations public. In other words, the PCAOB has existing statutory authority to address these public policy concerns; thus we believe that amending Sarbanes-Oxley is unnecessary.

5. Transparency of Audit Partners. In October, 2011, the PCAOB issued a proposed rule--"*Improving the Transparency of Audits: Proposed Amendments to PCAOB Auditing Standards and Form 2*" that would require identification of the audit partner and certain other independent firms and participants along with the percentage of hours worked in the audit report.

We have appropriately questioned the PCAOB on whether the identification of the engagement partner in the audit report will improve audit quality and auditor accountability and have expressed concerns about increased liability to, and safety of, the individual audit partner. We suggested an alternative that identifies the audit partner in firms' annual reports to the PCAOB (Form 2) rather than the audit report in SEC Form 10-K.

The profession also supports providing additional information to investors to enhance the understanding of the auditor's role and responsibilities and the audit process, including certain information regarding the use of other firms in the

audit. We have suggested 1) a higher threshold for disclosure, such as 10 percent or 20 percent participation which aligns with existing FASB, SEC and PCAOB guidance and 2) using ranges to indicate participation as opposed to requiring disclosure of precise participation percentages.

We hope the PCAOB will consider this more balanced, but still robust approach.

I also want to note two recent regulatory rulemakings where we believe the PCAOB and the SEC have adopted rules that overlook the appropriate balance between regulation that protects the public and regulation that overly burdens businesses and their auditors.

The first relates to audits of non-public, not-clearing, non-custodial (known as “introducing”) broker dealers and the second relates to audits of pooled investment vehicles (“PIV”).

Congress explicitly gave the PCAOB in the Dodd-Frank Act the authority to determine which nonpublic broker-dealer auditors should be part of an expanded regulatory structure that includes PCAOB auditor oversight and inspection. Rather than tailoring its approach to those broker-dealers that pose the greatest risk, the PCAOB has adopted an interim rule requiring that all auditors of nonpublic broker-dealers be registered and inspected.

We believe that regulations—and the resources to implement those regulations-- should focus on where there is greatest risk to the investing public and that auditors of non-public introducing broker-dealers do not pose that risk and, therefore, should not be subject to PCAOB oversight and inspection.

The second issue involves amendments to the SEC’s custody rule. In its custody rule, the SEC determined that all PIVs must be audited by independent public accountants “subject to regular inspection by” the PCAOB. However, some CPA firms that previously have specialized in PIV work do not audit public companies and, therefore, cannot be subject to PCAOB inspection. This regulation denies those CPA firms the ability to continue to audit their PIV clients, which are not publicly-traded companies. We do not believe it appropriate for the SEC to effectively ban an otherwise qualified firm from conducting this work through its rules.

Another area of continuing discussion in the policy arena is the requirement for auditors to attest to a public company's internal controls over financial reporting under section 404(b) of Sarbanes-Oxley.

The Dodd-Frank Act made the exemption from this auditor attestation requirement permanent for public issuers with market capitalizations of less than \$75 million. In recent months, there have been multiple proposals to raise this exemption for larger companies and/or to provide an on-ramp for new public companies. While we oppose exemptions to Sarbanes-Oxley section 404(b) for existing issuers, we appreciate Congress' effort to promote capital creation for small businesses through the more focused approach of the IPO on-ramp legislation.

As I mentioned earlier, effective internal controls are an integral part of an entity's financial reporting system. The U.S. Government Accountability Office has recognized this concept and requires auditors of entities subject to an audit under Generally Accepted Government Auditing Standards to issue a report identifying weaknesses in internal control over financial reporting that were noted during the financial statement audit.

Let me complete my remarks by reiterating the CPA profession's foundation of commitment to the public interest, our history of objectivity, independence and integrity and as well as the important services CPAs provide to U.S. businesses of all sizes and to investors and the profession's role in the global economy and global capital markets.


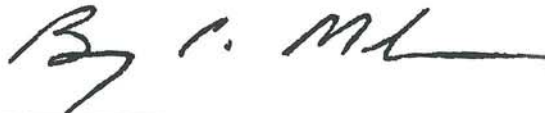
The U.S. retains the most sound and credible financial reporting in the world and I am here to assure you that CPAs in all areas of the accounting profession, along with the American Institute of CPAs, join you as we seek to advance a common mission of promoting the highest quality accounting and auditing services that are valuable to the public interest and to the global capital markets.

Thank you for the opportunity to testify today.

United States House of Representatives  
Committee on Financial Services

"TRUTH IN TESTIMONY" DISCLOSURE FORM

Clause 2(g) of rule XI of the Rules of the House of Representatives and the Rules of the Committee on Financial Services require the disclosure of the following information. A copy of this form should be attached to your written testimony.

<b>1. Name:</b> Barry C. Melancon	<b>2. Organization or organizations you are representing:</b> American Institute of Certified Public Accountants
<b>3. Business Address and telephone number:</b> 	
<b>4. Have you received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?</b>  <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No	<b>5. Have any of the organizations you are representing received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?</b>  <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
<b>6. If you answered .yes. to either item 4 or 5, please list the source and amount of each grant or contract, and indicate whether the recipient of such grant was you or the organization(s) you are representing. You may list additional grants or contracts on additional sheets.</b>          	
<b>7. Signature:</b> 	

Please attach a copy of this form to your written testimony.