As a senior financial executive in a public company that is subject to the internal controls assessment and independent auditor opinion on our assessment I am deeply concerned with the direction that this rulemaking is going. Prior to joining my current employer I had the pleasure of working for two of the remaining four large public accounting firms.

I am impressed by many of the comments you have received thus far, especially by the fact that many of my peers and individual investors have pointed out several of the challenges facing businesses as we work in good faith to implement these rules.

The Profession Comes First

Having worked for many years in two of the largest public accounting firms as a financial auditor I am all to familiar with the efforts which were made by our national practice office and our local regional offices to ensure that our approaches, methodologies, pricing, and pay-scales were “closely aligned” with our competitors. We were taught to compete – but to never undercut our competitors. We were taught to try to attract talent from a competitor – but only in limited quantities so as to prevent their management from going to our management and raising “raiding” allegations. We were taught to never undermine or undercut our competition in the market place for fear that it would make the whole profession look bad.

Occasionally we had a renegade employee or partner who got a little too aggressive in the marketplace. Whenever this happened the regional director would call in the partner and his goals would be “re-prioritized.” Sometimes, these partners would be transferred to other positions or accounts. The partners were taught two primary principles: “never lose an account” and “never start a competitive turf war with one of the other major firms.”

Optics Are Everything

It was always clear that each firm offered essential the same solutions. It was not uncommon for us to receive “briefing sessions” from senior partners communicating how we should respond to particular issues that from time to time confronted the profession. These sessions usually were restricted to the partner ranks and included detailed “talking points” to make sure that we all communicated a consistent and positive message. During these sessions the views and opinions of the other firms were openly shared and discussed. More often then not it was clear that the position we were taking would be consistent with the position that our competitors took. For me this occurred during the Savings & Loan Crisis.

A Client’s View

Now, sitting on the other side of the table as a client, I see how destructive these incestuous relationship really are. When I ask my external audit partner and their competitor to share with me their perspective on a particular current event – the answer is always the same. There is no intellectual insight or value provided when these accounting-robots churn out their standard fast-food accounting checklists and policy directives. On the major issues the firms consistently provide a standard well-coordinated message.

Having been raised within the public accounting community it is fairly transparent to me that this is occurring. What is more surprising to me is the fact that the firms often ask their clients to assist in them in their endeavors to share information with one another. Our external auditor has asked us to secure competitive intelligence on their behalf as well as to share “confidential” information with key contacts at other firms. The intent is clear – to send a message, a signal, to their competition on where they area headed on a particular issue. Although they must have direct channels of communication at the top of these firms there is a significant amount of activity that occurs at lower levels in the firms.
Clandestine Partnerships?

Personally, I believe that this type of activity has increased significantly over the past few years. This is especially true in how consistent the message has become among the large firms in what they perceive as being required and how significant their role needs to be when we discuss Sarbanes-Oxley. Our external auditors have recommended to us that not only do they need to participate, to a significant degree, on the overall project steering committee but they have also suggested to us that one of their competitors is better qualified than another (non big four) competitor to assist us in our endeavors. They have obviously established a “teaming” relationship with the other large firm in our (geographic) area. They “highly recommend” that this particular competitor perform those services that they cannot perform for us (namely some of the testing activity). This seems odd – but one can only assume that their competitor provides them with a similar endorsement.

What is disturbing to is that in our situation, we had two additional competitive bids from other firms (one big four and one non-public accounting firm). The non-public accounting firm actually presented what we considered a very robust approach to Sarbanes-Oxley compliance. We felt they could provide significant value to our organization. Their approach was unique and absolutely different then the proposals we received from the other larger firms. They came to the table with a software solution to help us document controls. They had a better approach around some of our key business systems and were able to demonstrate some specific experience and skills in this area. And, they were significantly less expensive (by a magnitude of 35-40% less) then their big-four counterparts. Overall, we felt more comfortable with their approach and their people.

Using Audit Fees As a Hammer

Unfortunately, our external auditors advised us that if we used this firm they would likely have to re-perform many of the procedures. The net effect would be our total costs (using this third party) would be equal to or greater then the fees we would pay by using our external auditors “preferred partner.” This caught our attention. It was made very clear to our management team: we either worked with our auditor to participate on the project and use their big-four counterpart or we risked having them come in and re-perform many of the same procedures that we proposed to do internally with the assistance of this other firm.

We have deferred our decision until your rules are finalized. But, we are very uncomfortable with where this is headed. It was made clear to our company at least that our external auditors would have the final say on how our project was organized. They arrogantly used the term “pay me now or pay me later” when speaking with our executive team.

Our CEO was so offended by that remark that he asked me to write this letter to you. He feels as if our external auditor has been put in a position of unbridled power. He is questioning how we can justify to our shareholders paying millions of dollars per year to comply with these requirements. He is devoted to meeting the letter and spirit of the law. However, we are increasingly irritated by what he perceives as unrelenting pressure by our auditors to incur costs needlessly and to incur costs for initiatives that provide no meaningful value to our shareholders. This brings me to our second point.

Repackaging Non-Audit Services

Our external auditors have brought a number of different teams of specialist to meet with us. Some to talk about our accounting systems, some to talk about our networks, some to talk about our tax structures, and finally some to talk about our consolidation system. In each situation the story is about the same. They would like to bring in their team of “specialists” to help us develop a business continuity plan, a state and local tax compliance program, an attack and penetration assessment of our network, or an improved financial close process using some new consolidation software.

In each of these situations the goal is to help us comply with Sarbanes-Oxley (404) and get some real business value (cost savings?) at the same time. The idea is interesting. Hire the specialist to help improve our business processes or risk points and achieve a positive return on our investment in Sarbanes compliance. Our auditors have proposed that by taking on these special “404-related” projects they could help us ease the “compliance burden” and get real value from our documentation initiative. The catch? In everyone of these discussions they refer to these projects as “audit related.”

We have asked them to put their ideas into proposals that we can share with our audit committee who has to approve all projects where the external auditor is engaged to provide additional services. Our auditors have steadfastly refused these requests. They have hinted that in order to gain audit committee approval for these projects they need to be “audit related” and that they need to “protect” our audit committee by not suggesting (in a proposal or presentation) that these are anything but something related to the audit. They have pointed that we are allowed to engage them for audit related activity and that these ‘special projects’ should fall into that category of services.
Obviously we are fairly skeptical about this approach. Our Senior Management team has more integrity than that. My CEO has stated that he will have nothing to do with these types of dealings and that the tactics and principles of our auditors are absolutely unacceptable. He does not want us to enter into any agreement with our external auditor that is not fully and completely disclosed to our audit committee and board of directors. The suggestion and innuendo by our auditors is disconcerting to say the least. But they are not alone. We have had conversations with some of the other Big 4 firms and they have also indicated that they are often required to call things “audit related” when in fact they are clearly more than “audit related”. Some of my colleagues at other companies have expressed to me privately that they have these same sorts of discussions with their external auditors.

For this reason, we would believe that your rules should clearly state that the external auditor is prohibited from assisting in documentation of internal controls or any other service not directly related to the performance of a financial statement audit.

Subtle Threats

Our external auditors have placed us in an uncomfortable position. There is incredible pressure to do what they want to ensure that we secure a clean audit opinion. We have taken the internal position, with the support of our Board of Directors, that our external auditors should be completely barred from providing any service other than the audit itself. They should not be allowed to provide tax, information technology, internal audit, operational audit, or any other service to their audit clients.

We have communicated our Board’s intent to our Coordinating Partner and several members of their team. We are trying to maintain a positive relationship with them and are reluctant to switch providers because we believe that these tactics are fairly uniform among the large firms. Any clarity you can provide in your rules to address these types of behaviors and to send a clear message to auditors that this type of behavior is unacceptable will be greatly appreciated. For the most part, we think we can meet the requirements and we would like the freedom to prove that we care about internal controls as much if not more than our external auditors.

Sincerely,

Silvio Berlusconi

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