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Public Company Accounting Oversight Board

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Statement of William J. McDonough on PCAOB
Proposed Rules On Auditor Independence and Tax Services

December 14, 2004 Public Meeting of the Board

I am very pleased with this proposal. I think it is right for the investing public because it will keep the auditors of public companies out of the aggressive tax work that has so damaged the public's confidence. It is right for the auditing profession, too, because these proposed rules draw clear lines to distinguish inappropriate services that impair auditor independence from permissible services that are not detrimental.

In recent years, the provision of tax services by the auditor has generated a fair amount of uncertainty. I hope and expect that today's proposal will bring some clarity to the issue. We have gone to great lengths to develop a robust record on the types of tax services that auditing firms offer. We have also devoted significant thought to making sure that we prohibit only those services that contribute to the problems we have identified. We believe that this proposal does that.

In each of the areas our proposal addresses, I believe that it is appropriate, and necessary in the public interest, to set high standards of ethics.

First, in the area of contingent fees, I believe it is right to align our rules with the rules of the SEC. There is some evidence that the profession has interpreted the SEC's exception to be the rule as it applies to tax services, and so we would make clear that that is not the case.

Second, I fully support the proposal's effective prohibition on accounting firms marketing or otherwise becoming involved in aggressive tax shelter products. I am pleased that the proposal keeps us out of that thorny debate over how to define a tax shelter. I am also pleased that it builds on existing frameworks that tax accountants already know and use. With respect to the proposed prohibition on listed and confidential transactions, there should be little need for accountants to identify information, or transactions, that they are not already tracking.

As Doug Carmichael has described, the proposed rule would also prohibit transactions with insufficient support in the tax laws. I think the "more likely than not" standard fairly recognizes that few aspects of the law – including the tax laws – are indisputable. An audit firm that commits its name to a tax opinion based on an aggressive interpretation of the tax laws, however, often has a financial stake in the transaction that, naturally, can impair impartiality and good judgment. The proposed rule should help auditors stay clear of more aggressive tax work that can put them in an inappropriate position of advocating on behalf of a client at the same time they are charged with objectively passing on the fairness of the accounting and presentation of the transaction at issue.

Third, I am pleased with the balance we've struck in the proposal on executive tax services. Knowing that an auditor has no special relationships with audit client executives involved in the financial reporting process instills confidence that the auditor's judgment is unbiased.

Some have argued that auditors should be permitted to perform tax services for senior executives of audit clients in order to assure investors that those executives are not evading tax laws or otherwise involved in questionable conduct. I have two things to say about that argument. First, if a corporate board needs such assurance, then in my view, it has the wrong management team. Second, the argument has the same flaw as the argument that auditors should be permitted to keep the books of their audit clients, on the theory that the auditors will at least make the books right. Undoubtedly expert accountants can prepare impeccable books, but in doing so they lose the impartiality that is critical to their role.

Finally, I believe our proposal appropriately complements the Sarbanes-Oxley Act's vision that audit committees should take responsibility for managing the relationship with the auditor, in the best interests of the company and its investors. I hope that the discussions that our proposal would require about the potential effects of tax services on auditor independence are taking place already in board rooms. And I understand, anecdotally at least, that they are in many board rooms. This practice should become the norm. In order to make those discussions most valuable, I believe that it is important that the auditor compile and provide to the audit committee fairly detailed information about the nature of proposed services and any special compensation arrangements.

Overall, I think we have set forth a narrowly tailored set of rules designed to address specific problems. We could have approached the topic with a broader brush, by prohibiting tax services entirely. I do not think that is necessary, nor do I think it would have been appropriate.

I believe that the investing public distinguishes the kind of aggressive tax shelter work for corporate clients and senior executives that we have seen in recent years, from the traditional tax compliance work that firms – both large and

small – have provided public company clients for decades. I do not think that the concerns we have identified – that some accounting firms have compromised their ethics for self-interest – justify a complete ban. But, these concerns do require that the remaining imperfections in our system be corrected.

I am very pleased with the recommendation before us. Thank you for all the hard work.