PETER CLAPMAN written presentation PCAOB Roundtable, April 3, 2014

In connection with this Roundtable, the PCAOB is examining important issues that address the disclosures given to investors about the audit process. In my opinion, the disclosure system presently is flawed in material respects and improvements are necessary. The PCAOB has advanced certain proposals that while modest in scope, would be beneficial and should be implemented. As discussed below, I support these proposals.

I speak about these issues in my personal capacity and not on behalf of any organization with which I am involved presently or in the past. In doing so, I draw on my experience as former chairman of the International Corporate Governance Network and my role as Chief Investment Counsel of TIAA-CREF, which is the largest global pension system in the world. In this latter role, I also headed up the corporate governance program. In many respects, the developments globally on these very issues under consideration are far more beneficial to investors than the current situation in the United States.

I start with the conclusion that the PCAOB has identified a major flaw in the current system of financial reporting and the audit process. That flaw is the asymmetry between what issuers know and what investors know about these matters. This asymmetry should be corrected in order to protect investors. The specific questions raised here all flow from this underlying problem.

In my view, the PCAOB has proposed very modest changes in the reporting system that should be widely embraced. For example, in proposing better disclosure regarding "critical

audit matters", the current "pass-fail" system is retained but not to the exclusion of providing additional information to investors. Often a company might "pass" but only after the auditor had to reconcile serious questions in the audit process. In my view, the fact that serious questions surfaced should be disclosed to investors.

The two new disclosures, being proposed by the PCAOB, are also modest in scope:
1-provide the tenure of the audit firm, and
2-provide the name of the lead engagement partner of the audit firm.
These disclosures are relevant to many investors and would impose no additional costs for the issuer. These disclosures should be broadly embraced.

The process of selection and retention of audit firms has proven to be a contentious issue. Many investors consider tenure to go to the very question of whether the audit firm has the requisite independence that the financial reporting system requires. Globally, the regulatory process has taken these concerns seriously; in the UK and the EU, we may well be moving to a system of requiring audit firm rotation or rebidding of the audit assignment at certain time intervals.

In the US, these possible requirements have been discussed but have been opposed by broad segments of the market. Some observers believe that the requirements of the past decade which provide for rotation of audit firm lead engagement partners should satisfy independence concerns; they also believe that going further would increase costs and might even be harmful to good audits. Thoughtful individuals and organizations sincerely hold these opinions, but they are opinions, which are disputed by other individuals and

organizations, which do not share these concerns, or who ascribe different priorities and values to particular aspects of the audit firm selection system.

The issue at hand, namely the PCAOB modest proposal to include the tenure of the audit firm in the auditor report, should not raise the contentious arguments that have surfaced on the broader questions. The inclusion of audit firm tenure does not involve costs---there are none---nor would inclusion intervene in the discretion of the audit committee of issuers in the selection process.

Some investors will want the information about tenure because they believe that long-standing tenure, ranging in some cases into the decades, does raise concerns about independence. Other investors may not be as concerned and might ignore the disclosure if provided.

Since costs are not the issues, the opposition may be based on a concern that the disclosure of tenure is another way to raise the larger issue of whether long-term tenure is contrary to good governance. If information is provided, there is a risk that investors to a greater degree will assess that information and raise questions with the issuers who have to report tenure of long-standing. That concern is not, in my view, a sufficient reason to avoid providing this information since many investors want the information and are professional enough to use it well. Investors should decide what information they receive as long as it does not significantly raise costs to other investors.

Similarly, the inclusion of the name of the lead engagement partner of the audit firm should be provided. If publicly available, audit committees and investors would be able to

access the past record of the particular partner. If an issuer is considering the utilization of a lead partner, who has a record of questionable audits in the past, that issuer's audit committee is in a better position to raise questions. Investors would have a meaningful basis for assessing the performance of the audit committee of companies. Since this would be a costless requirement, all investors would benefit from such disclosure.

In conclusion, the underlying problem being addressed in the PCAOB proposals is the asymmetry of information between managements and investors. The proposals are modest in scope and would cost virtually nothing to implement. We should start with the recognition that the current disclosure of audit firm selection and retention is inadequate and needs appropriate changes. The ultimate principle should be to enhance investor protection in these critical areas. Investors should be trusted to use the information, if disclosed, properly and intelligently.

I urge the PCAOB to move forward with these proposals.