



**Written Testimony of Barry Salzberg
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before the
U.S. Department of the Treasury
Federal Advisory Committee on the Auditing Profession**

**February 4, 2008
Los Angeles California**

Chairman Levitt, Chairman Nicolaisen and members of the Committee, thank you for the opportunity to share our perspective on the important work of the Advisory Committee in this written testimony.

Since June 2007 I have been the CEO of Deloitte LLP (which until February 1, 2008 was known as Deloitte & Touche USA LLP). The Deloitte US firms include four subsidiaries that provide client services, including Deloitte & Touche LLP, which provides audit services. I have been with Deloitte for over 30 years and have served in a national leadership role since 1999. Immediately prior to becoming CEO, I was the Managing Partner of the U.S. Firms. I am also a member of the Board of Directors of the Deloitte U.S. firms, the Deloitte Touche Tohmatsu (DTT) Global Executive Committee, and the DTT Global Board of Directors.

During the time that I have served in a national leadership role at Deloitte, I have witnessed many changes that have profoundly impacted the auditing profession. Some of these are broad market changes to which audit firms have had to adapt, such as the increasing globalization of markets and our clients' operations, the increasing complexity of companies and their reporting requirements paired with the acceleration of reporting deadlines, and rapid changes in technology impacting companies' operations and reporting. These changes have been accompanied by an astounding proliferation of financial products and accounting rules. Other changes have been more focused on the auditing profession and have heightened the focus on a continued need for improved audit quality. These include reforms promulgated by the Sarbanes-Oxley Act of 2002, including the creation of the Public Company Accounting Oversight Board, rules related to companies' internal controls over financial reporting, and expanded responsibilities of public company audit committees related to selection and oversight of outside auditors.

We commend Secretary Paulson for recognizing that this is an appropriate time to take stock of the impact of these changes on the profession and the markets as a whole, as well as to consider additional changes that may impact the profession in the coming years. Now is a propitious time for the Advisory Committee to examine issues impacting the auditing profession, as the Committee can benefit from recent work on related issues by various private sector and government entities, including the U.S. Securities and Exchange Commission's Advisory Committee on Improvements to Financial Reporting (CIFiR) and the U.S. Government

*Testimony of Barry Salzberg
February 4, 2008*

Accountability Office's updated study on concentration and competition in the auditing profession.¹

The Advisory Committee set out in its Working Discussion Outline a very comprehensive list of issues, each of which is important to the auditing profession to varying degrees. These issues do not stand alone, but are complex and highly interconnected issues that do not lend themselves to isolated solutions. To this end, it is important that the Advisory Committee take a holistic approach in its work, recognizing that certain recommendations may only be effective if linked with others, and that some recommendations which may appear sound when focusing only on a single issue could have an unintended impact in another area. It is also important that the Advisory Committee ensure that all of its recommendations are directly linked to its stated objective of making recommendations on the sustainability of a strong and vibrant public company auditing profession.

Before I directly address the topic of the panel on which I will be speaking—Human Capital issues facing the profession—I would like to discuss several other important issues that we believe are the most important for the Advisory Committee to consider in fulfilling its objective to sustain a strong and vibrant profession.

THE SUSTAINABILITY OF THE PROFESSION

The most serious threat to the long-term sustainability of a strong and vibrant auditing profession is the risk of another large firm failure. In our view, if a firm fails, it most likely will result from the consequences of private litigation or a regulatory action, the cascading effects of which are disproportionate to the conduct at issue. The continuing erosion of respect for professional judgment contributes greatly to this risk, and therefore also must be addressed. Moreover, the fear of being second guessed, which arises from the litigation threat and the regulatory environment, is currently serving as a barrier to further improvements to financial reporting and audit quality, as preparers and auditors seek more detailed rules to address the risk. Consequently, as discussed in more detail below, we urge the Advisory Committee to address this issue in its recommendations. Among the recommendations to consider in this area are:

- Legislative reform to the private litigation system, including caps on catastrophic auditor liability and certain reforms to the bankruptcy laws
- Regulatory changes to the private litigation system, including a return to the application of Section 10(b) to punish true fraud, and explicit allowance of the use of alternative dispute resolution for claims relating to accounting and auditing issues
- Protections against regulatory action in the U.S. and globally that have cascading effects disproportionate to the conduct at issue
- A rule or framework to reinforce the importance of professional judgment

¹ Audits of Public Companies: Continued Concentration in Audit Market for Large Public Companies Does Not Call for Immediate Action, United States Government Accountability Office (January 2008) (hereinafter “January 2008 GAO Report”).

*Testimony of Barry Salzberg
February 4, 2008*

We believe that these suggestions will enhance the continued sustainability of the profession, in a way that is consistent with a strong system of investor protection, which we strongly support. Investors have a strong interest in a healthy, effective auditing profession, and this interest is not well served by our highly inefficient private litigation system. The Advisory Committee should recognize that in the past five years we have moved towards a more direct and effective means of ensuring audit quality and compensating harmed investors. For example, the Sarbanes-Oxley Act provided for direct regulation of the profession by creating the PCAOB. The PCAOB has substantial resources (a budget of \$144.6 million for 2008) and broad authority to inspect firms, take enforcement actions, and impose penalties that include barring an audit firm or auditor from auditing public companies—these mechanisms provide more compelling incentives to maintain audit quality, and therefore more direct protection for investors, than any civil litigation could. A second example, focused on the need to compensate investors, was also addressed by the Sarbanes-Oxley Act, namely, the creation of the Fair Funds mechanism to allow the SEC to return ill-gotten gains to shareholders.

Private Litigation

Civil litigation serves an important purpose in our society, and legal exposure is a cost of doing business for any enterprise. We do not believe that auditing firms should be insulated from normal legal risk or the related costs. But the risks faced by firms that engage in public company audits are far different from those of most businesses. Currently, each large public auditing firm and global network faces the risk of a single catastrophic liability award so large that the firm or network could be destroyed. This is in part because each public company audit engagement potentially exposes the firm to liability that could be measured by the full market capitalization of the client in the event of a shareholder suit, no matter what the audit firm's actual culpability—if any. Moreover, audit firms have this same exposure for each public company they audit and thus bear many multiples of the risk that any one public company bears related to a suit by its shareholders. In addition, these client-specific risks are far out of proportion to the audit fees earned by the audit firm from such clients. For example, in one matter that our firm settled in recent years, our annual fees from the engagement were roughly \$100,000, yet we ultimately settled the case for far more than \$200 million. As you can imagine, the potential damages from litigating were a multiple of the settlement amount.

Although there is a very modest amount of insurance available to firms like ours, it has large deductibles and is totally insufficient to address the risk arising from the loss of a company's market capitalization in these cases. As Aon, a leading insurance and risk management firm, noted in a 2005 report "the auditing profession is one of the very few where insurance protection for catastrophic losses is simply not available."² When facing mega claims at amounts that vastly exceed the insurance and capital of even the largest firms, the firms are most often forced to settle claims rather than risk a jury trial. As defendants, therefore, audit firms are virtually shut out of the courts as a practical matter. The prevailing practice of settling claims due to the catastrophic risk of losing an adjudicated claim leaves the auditing profession essentially denied the due process that our courts are intended to provide. Further exacerbating this reality is the lack of consistent appeal bond caps. The lack of appeal bond caps means that if a firm loses a

² Mega-Claims: Analysis of a Selection of Large Publicly Known Matter Involving Auditors, Aon (Sept. 21, 2005).

Testimony of Barry Salzberg
February 4, 2008

case and is unable to appeal, it or its entire network can be destroyed based on an initial judgment, even if that judgment is flawed as a matter of law.

Although the profession thus far generally has managed its private liability burdens, there is a real risk that a large judgment, or series of judgments, somewhere in the world could result in a large firm or network being destroyed. Moreover, this liability risk could exacerbate issues the profession is already facing, including concentration, because increased liability exposure could serve as a barrier to entry for firms that otherwise could potentially develop a global capability and presence similar to the larger firms.³

And if another large firm were to fail, there would likely be grave consequences. At a minimum there would be a dramatic increase in audit fees, because the surviving audit firms could interpret the failure of the firm as confirming the concern that they are *de facto* “insurers” of the capital markets. But there is also a very real risk that it would not be possible for the remaining firms to fill in the gap. For example, the remaining firms might not be willing or able to take on the role of insurers of the market, public companies could have few or no viable auditor choices to replace the failed firm that have both the necessary expertise and compliance with the current independence requirements, or the remaining firms could lose a significant number of professionals who decide that the profession has become too risky, thereby reducing the profession’s capacity to provide audits.

Given this risk, it is no surprise that addressing the threat of catastrophic liability is on the agenda of many public and private groups, including in the European Union. As the U.S. capital markets face increasing competition, we cannot afford to leave this issue unaddressed. A number of private-sector groups in the U.S. have given thoughtful consideration to this issue. The Advisory Committee, because its diverse membership includes representatives from all stakeholders in our capital markets, is an important voice in the discussion. We therefore urge the Advisory Committee to consider the risks and implications of another firm failure due to litigation and to recommend solutions. Among the solutions we urge the Advisory Committee to consider are:

Catastrophic Liability Caps. A cap on the liability that auditors could face for public company audits would preserve accountability of the auditing profession while protecting against failure of an entire firm. It would also afford audit firms full and fair access to the court system. The Advisory Committee should consider recommending legislation that would cap an audit firm’s total civil liability for an audit in both state and federal lawsuits. The exact form of such a cap would require further study, and as a matter of fairness should apply equally to all firms that audit public companies. The cap could, for example, be proportionate to the size of the audit or the company audited—perhaps a multiple of the audit fee. Regardless, we are confident that a meaningful mechanism can be developed that is set high enough to continue to provide a strong incentive to perform high quality audits, but at the same time protect the market against the catastrophic risk of another large firm failure.

³ See, e.g., January 2008 GAO Report at 38 (“Some firms and market participants told us that the possibility of being sued created disincentive against entering or expanding in the audit market for large companies because the failure of one large client could jeopardize the audit firm”).

Bankruptcy Law Reform. Audit firms face enormous exposure in cases brought under a simple negligence standard by trustees and receivers of audit clients that become bankrupt or insolvent. This is true even when company personnel engaged in misconduct that led to the bankruptcy or insolvency. For example, management of a company may be tempted to inflate revenues in order to keep the company afloat if it is facing financial difficulties. Historically, auditors were able to defend against suits brought by a trustee or receiver by pointing out that the trustee or receiver can bring these claims only because he is standing in the shoes of the audit client, and therefore the auditor can assert all the defenses that would have been available in a suit brought by the audit client prior to bankruptcy or insolvency—including that the wrongful acts of management should be imputed to the company. Some courts have weakened this defense, however, either by holding that prior management’s misconduct should not be attributed to the trustee or receiver or by holding that the doctrine is inequitable to third parties, such as creditors of the company (parties who in most cases could not themselves bring negligence claims against the auditor). We urge the Advisory Committee to consider recommending legislation that would clarify that trustees and receivers do stand in the shoes of the company for all purposes.

Rule 10b-5 Reforms. As written, Section 10(b) of the Securities Exchange Act of 1934 prohibits “manipulative or deceptive” conduct. This clearly means conduct made with intent to defraud or deceive. Over time, the required showing of intent has been interpreted by the courts to permit imposition of liability for “reckless” conduct. Juries often have a difficult time distinguishing recklessness from negligence, or mistakenly believe that failure to detect a fraud is conclusive evidence of recklessness. Audit firms consequently risk liability for conduct that was not originally intended to be covered by Section 10(b). We therefore urge the Advisory Committee to consider recommending that the SEC reexamine the intent standard under Rule 10b-5 so that private claims brought under that rule are properly focused on intentional wrongdoers. We believe that this recommendation could be implemented by the SEC, without the need for legislation.

Alternative Dispute Resolution (ADR). The Advisory Committee also should consider recommending that the SEC support the use of ADR to resolve claims relating to accounting and auditing issues. There are two reasons for this: first, these issues have become incredibly complex, and jurors who have no background in these issues face a nearly impossible task in trying to gain a full understanding of them in the short period of a trial. Second, experience shows that ADR can be much more efficient than bringing matters to trial in the current litigation system. Most courts today have substantial backlogs, which often result both in extensive delays in obtaining a trial date and in little effective supervision of pre-trial discovery, which can become bogged down in side issues and incredibly expensive. In contrast, under ADR provisions, parties can choose arbitrators who have time available to supervise the discovery process and to conduct hearings promptly. In addition, ADR procedures generally focus the parties’ attention on central issues more quickly than litigation and encourage informal resolution when possible. We suggest that the SEC do two things: first, make clear that including ADR provisions in audit engagement letters does not impair the auditor’s independence. Although such ADR provisions are not currently prohibited by the SEC and do not impair independence, the SEC could facilitate their use by explicitly acknowledging that they do not raise independence issues. Second, the SEC should enable

Testimony of Barry Salzberg
February 4, 2008

companies to include provisions in their articles of incorporation that require the use of ADR for investor claims against the company and its advisors (such as auditors, underwriters, and lawyers). It would be up to the companies and their shareholders as to whether to include such provision in their articles of incorporation. In the long run, this could do much to improve our litigation system and thereby enhance the competitiveness of the U.S. markets.

Regulatory Environment

The catastrophic risk facing audit firms is not limited to civil litigation. Regulatory or government actions can have cascading effects that are disproportionate to the conduct at issue, even to the point of leading to the destruction of an audit firm—not only the firm in the regulator’s own country but also the firm’s global network. Those who commit wrongdoing should be held accountable, but significant risks are posed by regulators who could take action without considering its cascading effects. Andersen’s collapse, for example, was not caused by exposure to liability in a private lawsuit, but rather by a mass defection of clients and professionals due to a loss of confidence in the firm resulting from the initial threat of and subsequent indictment by the U.S. Department of Justice. The Andersen case demonstrates that a firm can be destroyed before any actual finding of culpability is made, if it ever is.

The Advisory Committee should consider recommending that the SEC take the lead to address this risk by developing memoranda of understanding (MOUs) with the Justice Department and state regulators on the importance of SEC involvement in decisions regarding actions taken against audit firms. SEC involvement in these issues would permit consultation with the PCAOB, which directly regulates public company audit firms. The Advisory Committee also could encourage international dialogue on this issue by recommending that the SEC stimulate discussions among other national regulators, perhaps through the International Forum of Independent Audit Regulators (IFIAR) or the International Organization of Securities Commissions (IOSCO), with the objective of developing workable arrangements that would address the impact of potential decisions in other geographies.

Professional Judgment

The increasing number of challenges to reasonable professional judgments in the regulatory and litigation system contributes greatly to the liability and regulatory risks the firms are facing. The importance of professional judgment is recognized in U.S. GAAP and PCAOB auditing standards, both of which require the exercise of such judgment. In practice, however, reasoned judgment appropriately executed and documented is not always accepted by regulators and is often exploited by civil litigants who use, often successfully, subsequent events to claim after the fact that a judgment was flawed.

The fear that judgments will be second-guessed impacts the quality of our financial reporting and auditing systems, because it causes preparers and auditors to seek assurance in the form of detailed rules and interpretations, which contribute to the complexity of the accounting and auditing systems under which we operate today. The ability of accountants and auditors to exercise their professional judgment with confidence will become even more important if we move to a global principles-based approach to standards, such as International Financial Reporting Standards (IFRS). Finally, increasing the respect for the auditing profession and the

Testimony of Barry Salzberg
February 4, 2008

judgment of its professionals is important to addressing the human capital issues the Advisory Committee has identified.

The Advisory Committee should consider recommending that the SEC formally adopt a rule or framework that recognizes the essential role of good-faith professional judgment in the auditing profession. Such a rule or framework should provide protection in appropriate circumstances from civil liability and SEC or PCAOB action, and could mirror the well-established “business judgment rule” that limits liability of corporate officers and directors with respect to decisions “made in good faith and in the exercise of due care.”⁴ A judgment rule or framework should cover judgments reached in good faith, based on a rational belief that applicable accounting principles or professional standards were appropriately applied. We believe the protection afforded to good faith judgments by the rule would improve audit quality, reduce the number of restatements, as well as emphasize to investors that judgments are an inherent part of financial reporting and the auditing process. We understand that CIFIIR intends to recommend that the SEC adopt such a professional judgment rule. We find this encouraging and believe that such a rule should cover judgments made by preparers of financial statements as well as their auditors.

CONCENTRATION AND COMPETITION

We agree with the statement in the Advisory Committee’s Working Discussion Outline that the auditing profession “benefits from a competitive and innovative population of auditing firms.” Although there currently is concentration in the large public company audit market, this does not correlate to a lack of competition. In fact, our experience shows very healthy competition in the auditing profession—an experience that is reinforced by recent GAO findings.⁵ There are, however, some steps that we believe the Advisory Committee could recommend to alleviate the degree or effects of concentration in the profession.

This includes relief from the catastrophic litigation and regulatory risks, discussed above, as well as relief from overly-restrictive auditor independence requirements, which disqualify firms from competing for public company audits even where there is no independence impairment. Therefore, as discussed in more detail below, we urge the Advisory Committee to recommend amendments to current independence requirements, including:

- Allowing for *de minimis* exceptions for scope of services violations
- Amending the definition of “affiliates” of audit clients to reflect currently prevalent business structures
- Lengthening partner rotation periods

These changes to U.S. independence requirements, as well as those discussed in the human capital area below, would be wholly consistent with movement towards international convergence with the independence standards that are issued by the International Federation of Accountants (IFAC). IFAC follows a “threats and safeguards” approach, pursuant to which

⁴ *In re J.P. Stevens & Co. S’holders Litig.*, 542 A.2d 770, 780-81 (Del. Ch. 1988).

⁵ *See, e.g.*, January 2008 GAO Report at 15 (“most participants [in the GAO study] did not see the current level of concentration as significantly effecting these aspects of competition [namely, audit choice, audit prices and audit quality]”).

Testimony of Barry Salzberg
February 4, 2008

possible independence concerns are assessed first by identifying any threats to independence and evaluating whether these threats are clearly insignificant. In cases where they are not clearly insignificant, the IFAC approach then allows for identification and application of appropriate safeguards to eliminate or reduce the threats to an acceptable level.

The changes that we urge the Advisory Committee to consider, however, can be achieved whether or not the movement toward convergence of independence standards progresses. For example, the following requirements, which are designed to help ensure auditor independence but can serve to exacerbate concentration by limiting the number of firms who can compete for audit engagements, should be among the topics on which the Advisory Committee recommends reform:

Scope of Services. Neither the SEC's nor the PCAOB's rule on scope of services currently contain a *de minimis* exception for violations, even for immaterial non-audit services or in instances where the company agrees to have the service re-performed by another entity prior to the audit. Under the "period under audit" standard in the SEC's rules, even one month of bookkeeping services provided to a minor subsidiary of a potential client disqualifies a firm from bidding for the audit. Such limitations prevent public companies from having a full choice of providers.

Definition of Affiliate. The definition of "affiliates" as interpreted in the current rules is too broad and does not reflect today's businesses, especially in the context of private equity funds and investment company complexes. We believe that the current interpretation of the definition of affiliate is unnecessarily restrictive. For example, by providing an independence impairing service to one of dozens of mutual funds sponsored or administered by an investment company, an auditor would be ineligible to propose on the audits of as many as a thousand "affiliated" entities. This impacts auditor choice for those entities more than is necessary to safeguard independence, in some cases leaving the entity with a choice of only one or two audit firms that have both the necessary expertise and compliance with the current independence requirements to conduct the audit.

Partner Rotation. The required frequency of partner rotation put in place by the Sarbanes-Oxley Act and related SEC and PCAOB rules, especially when combined with the mobility impediments created by the current licensing regime that are discussed below, can impede a firm's ability to optimally deploy partners on audit engagements. The justification for frequent partner rotation is even less compelling for concurring partners, because the nature of their role does not present the same risk to independence as does the role of lead partner. The Advisory Committee should therefore consider recommending extending the requirements from five to seven years for lead and concurring partners. Other elements of Sarbanes-Oxley, including the expanded role of the audit committee and the formation of the PCAOB, provide more than adequate safeguards for a seven year rotation regime. The Advisory Committee should also consider recommending that the rules allow those partners to have some limited involvement with the audit, both before and after they serve as lead or concurring partner, in order to help ensure a better transition between partners. We believe these changes would not lessen independence and would provide for appropriate continuity on the client engagement. This would benefit all firms in relieving an aspect of

*Testimony of Barry Salzberg
February 4, 2008*

concentration, but would particularly help the smaller firms struggling with the five year rule, given their more limited number of partners.

The Advisory Committee also should be mindful of concentration issues that may arise in other areas it may be considering. For example, when discussing the issue of audit firm transparency, the Advisory Committee should focus on information that is relevant to the public's ability to assess audit quality. Some discussions around audit firm transparency instead appear to focus on audit firms publicly disclosing information of any type, including disclosure of detailed firm financial data, merely because the firms serve the public interest. We urge the Advisory Committee to focus its considerations of transparency directly on audit quality, as has the EU in Article 40 of the Eighth Company Law Directive.

This is important because there is a risk that if taken too far transparency would exacerbate the concentration in the marketplace without concomitant improvement in audit quality. This could result because audit committees may feel compelled to choose firms with the largest financial and professional resources, rather than a range of other qualified firms based on more appropriate assessments of quality and fit. The PCAOB's oversight, including its access to a broad scope of non-public information about the firms, allows for any additional independent oversight of the firms that the Advisory Committee may believe prudent without requiring public disclosure, thereby avoiding the unintended consequence described above.

HUMAN CAPITAL

As a professional services firm, our people are our primary asset. In fact, the largest four U.S. firms alone employ more than 125,000 people. The ability to attract and retain talent is a central issue to the sustainability of the profession. The profession has put a great deal of effort into attracting and retaining talent and has some of the most progressive programs in this area among all businesses. These include programs designed to provide extensive technical and management training, career counseling and mentoring, and competitive compensation packages. The profession also invests in programs specifically designed to attract and retain women, minorities, and other diverse classifications of workers. We have also found that a wide choice of career paths within the firm provides an enormous benefit to our retention efforts, as does our willingness to work with our professionals to design a career path tailored to their needs and goals. The results of the profession's efforts have been recognized widely, including by such national publications and organizations as BUSINESS WEEK, FORTUNE, WORKING MOTHER MAGAZINE, Catalyst, Diversity Inc., and The Human Rights Campaign.

We believe that the Advisory Committee could make the greatest impact on the profession's ability to attract and retain talent by making recommendations to improve the general respect for and attractiveness of the auditing profession, including by addressing the sustainability and professional judgment issues discussed above. There are other important recommendations as well, which could significantly aid the profession in its continuous efforts to improve its ability to attract and retain top professionals, as well as deploy them on appropriate assignments. These include:

Testimony of Barry Salzberg
February 4, 2008

- Advocating a national licensing system
- Advocating an improved immigration experience for learned professionals
- Easing certain overly-restrictive independence requirements
- Supporting improvements to the attractiveness of the profession to college students through improved education and training

National Licensing

During the December 3rd Advisory Committee meeting, there was a discussion focused on the need to increase mobility to practice temporarily in another jurisdiction. Increased mobility for temporary practice is an important issue to the firms as we work to deploy the right personnel on audits. We understand that good progress is being made on this front at the state-level and are supportive of current efforts to increase mobility across state lines. There is a broader set of issues, however, that result from the current multi-jurisdictional regulation of the profession that we believe would be best addressed by a move to a national licensing system for firms and individuals.

A national licensing program would ease the current numerous and significant burdens placed on firms and individual professionals related to state licensing, in addition to temporary mobility considerations. These burdens include the increasing cost for deployment on various audits that arise from the multiple state-required continuing professional education requirements for initial and renewed licenses, and multiple disciplinary and ethics regimes, among other compliance issues. Unlike temporary mobility, these burdens do not seem to be easing. For example, although the creation of the PCAOB was intended to centralize and rationalize the oversight of the profession, some states have begun to piggyback off PCAOB actions, including by using information from its inspection reports to engage in duplicative oversight and discipline. In addition, although the states have made significant progress on the issue of temporary mobility, there remain impediments to optimal staffing based on licensing restrictions for permanent relocations. Consider the following examples:

- An experienced partner is chosen to serve as the lead audit partner on a complex client, which will necessitate a permanent move to a state that will require that partner to obtain a reciprocal license to practice. Although the partner has maintained all the requirements for his primary license and has been a practicing CPA for many years, he is unable to obtain a reciprocal license in the new state because he does not have enough college credits based on the specific requirements of the state in which the client is headquartered. Because that partner cannot obtain the required license, another partner must be assigned as lead partner on that client.
- A firm or individual is sanctioned for work on an audit that occurred entirely in one state by both the PCAOB and the disciplinary body in that state. In addition, the firm or individual could be subjected to investigation and possibly disciplined, based on the same conduct, in any other state in which that firm or individual holds a license, even though none of the conduct at issues took place in those states.

*Testimony of Barry Salzberg
February 4, 2008*

Therefore, the Advisory Committee's examination of the issue of redundancy of state and federal oversight of the profession should not be limited to the issue of temporary mobility, but should be broad enough to consider the many issues that arise in the current multi-jurisdictional system.

Improving Immigration

The Advisory Committee could assist in increasing the talent pipeline by considering recommendations to foster cross-border deployment of professionals by improving the immigration experience for legal, highly-educated workers. In our commitment to employing highly skilled and talented professionals, Deloitte and other public accounting firms use the U.S. Government's various visa programs, including H-1B and L-1 visas, to add to our talented and diverse workforce in order to provide the best and most efficient services to our clients.

Public accounting firms and other U.S. employers must be able to recruit from U.S. universities and retain critical talent, especially in fields where shortages exist. Many of the campus recruits that are highly sought after by public accounting firms require visas in order to work in the U.S. Unfortunately, the U.S. continues to lose valuable talent to overseas competitors as a result of the lack of visa options for foreign national professionals. For example, the H-1B visa is a highly coveted employment-based visa that allows foreign national professionals to work in specialty and professional occupation categories, including the audit and accounting professions. Each fiscal year, Congress only allocates 65,000 H-1B visas. Although this number may at first glance sound adequate, in fiscal years 2006, 2007 and 2008, the H-1B quotas were reached before the start of the respective fiscal year, leaving large gaps of time before new visas were available for employers to secure top foreign talent not available in the U.S. In fiscal year 2008 alone, Deloitte filed over 620 H-1B applications for highly talented young professionals graduating from U.S. universities and we expect this number to increase in the future. Hundreds of these applications were rejected due to the H-1B quota and the unavailability of visas. Consider the following examples:

- Our Capital Markets group is continually in need of professionals with very specialized skills to audit effectively the complex financial instruments that public companies use. There are a limited number of universities that offer masters degrees in financial engineering. In the past year, we identified and offered jobs to four qualified candidates, none of whom was able to obtain the required visa.
- This year 20% (19 individuals) of the campus recruits of one of our larger offices will require visas to stay in the United States. To date, five of those nineteen recruits have had their visa applications rejected. This leaves a key office in jeopardy of losing a significant number of highly qualified recruits who will be difficult to replace.

Global organizations such as the large public accounting firms, require the ability to transfer employees, access new workers in a global labor pool, execute contracts and complete client projects on time. In addition to the shortage of visas, processing delays at both the U.S. Citizenship and Immigration Services (USCIS) and the U.S. Department of State (DOS) often impede the organization's ability to do these things. For example, a visa application for a senior auditor scheduled to provide complex audit-related services to a client in the U.S. can be delayed up to three months should a U.S. Consulate abroad determine that the employee does not possess a "specialized knowledge" in the firm's methodologies. Additionally, visa applications are

*Testimony of Barry Salzberg
February 4, 2008*

significantly delayed when USCIS demands financial documentation and statements from executive officers to certify that the firm has the ability to pay employees the proffered wages. Employers, such as the large public accounting firms, that frequently petition for foreign workers should not have to continually “re-introduce” themselves to USCIS or DOS. A pre-certification program would streamline the visa process to enable employers with approved immigration programs to obtain work-related visas in a more efficient and timely manner.

The Advisory Committee could assist the profession in improving the immigration process by supporting legislation that will raise the H-1B cap from 65,000 to at least 115,000 visas annually, and allow employers who have demonstrated a positive track record to file their visa petitions through an expedited, pre-certification program.

Independence Rules

There are a number of auditor independence restrictions that are overly-restrictive and do not meaningfully promote the independence of the profession. These restrictions in fact contribute to human capital issues faced by the firms and therefore damage the attractiveness of the profession overall. The Advisory Committee should consider recommendations to ease these burdens in areas where there is no threat to independence.

Partner Rotation. In addition to our concerns about the effect of partner rotation on concentration, as discussed above, the shorter rotation period also has had a significant impact on the desirability of serving as an audit partner. For example, lengthening the rotation period from the current five years to seven years could reduce the number of times a partner’s family must relocate by one or two moves over the course of a professional career. Moreover, a lengthened period of partner rotation would improve the firms’ ability to keep specialized industry experts deployed on the appropriate audits. Lengthening the rotation period for lead and concurring partners would still provide the protections the rule is intended to provide by providing a regular fresh look at the audit, while assisting the firms (especially smaller firms) to appropriately deploy professional resources. The benefits of partner rotation could be maintained, and audit quality enhanced, by also easing the “other partner” rules,⁶ including eliminating the 10 hour rule and increasing the size of subsidiary that other partners can work on without becoming subject to the rotation requirements. This would allow for better transitions of lead partners as well as a greater pool of future lead partners on an audit.

Application of Rules to Outside Advisors. In addition, the independence requirements are so broadly applied as to impact negatively the efforts of the firms to obtain an outside perspective on important governance and talent issues. For example, we have had difficulty recruiting top outside candidates for our Diversity Advisory Board and Women’s Initiative (WIN) External Council, due primarily to the candidates’ affiliation with client’s boards of directors. We therefore urge the Committee to consider recommending that the independence rules be modified to allow firms to recruit such important outside advisors

⁶ The partner rotation rules apply to “other partners” who either provide 10 or more hours of service to an audit client or serve as lead partner on a subsidiary of the client that constitutes over 20% of the assets or revenues of the client. These “other partners” may serve seven years before they are required to rotate off of the audit for two years.

*Testimony of Barry Salzberg
February 4, 2008*

more easily. Moreover, in exploring issues related to broader firm governance, we have concluded that it would be very difficult to recruit qualified outside advisors, because they would become subject to the firm's financial and other independence restrictions, which would obviously limit candidates' willingness to advise the firm.

Education and Training

In our audit practice, and I am sure other firms have undertaken similar efforts, we have implemented numerous programs aimed at attracting, retaining, and developing the best talent. These include programs designed to provide extensive and meaningful on-the-job and formal training opportunities, career counseling, coaching and mentoring, focused career development programs, as well as programs to develop the specialists we need to meet audit requirements, serve our clients, and compete in the global marketplace. We believe that the Advisory Committee could assist our efforts by considering recommendations to improve the attractiveness of the profession to college students, including expanded curricula for accounting graduates, allowing more than nominal credit for firm internships to count towards requirements needed to sit for the CPA exam and attain certification, alternative curricula for non-accounting graduates, and the use of adjunct professors.

Today most state boards of accountancy have adopted a requirement for 150-hours of college credit to become certified as a CPA, rather than the 120 hours required by most bachelor's degrees. However, there is little or no consistency in the course requirements for the additional 30 semester hours in university programs or state requirements. The variations in individual state requirements create an unnecessary inconsistency in entrance requirements to the profession. The Advisory Committee should consider advocating for more consistency in the academic qualifications for certification. The increasing complexity of the issues facing auditors and public companies that I discussed earlier suggests that students would be better prepared for the demands of the profession if they had coursework in key areas such as ethics, fraud examination and forensic auditing, negotiation and communication skills, financial risk management, global business, taxation, and valuation. Additionally, universities should be preparing students for the possible convergence with IFRS. The Advisory Committee should consider advocating that universities offer coursework in the areas discussed above. Many of these areas require no additional accounting professors and therefore would not contribute to the existing and forecasted shortage of such professors.

Experience gained through internships and on-the-job training has been a cornerstone of recruiting for the profession. Practical experience and the ability to work with seasoned professionals provide a learning environment in which students begin to develop necessary professional knowledge and judgment. Additionally, professional experience has long been a requirement for certification. The Advisory Committee should consider advocating that universities grant substantive credit for internships in public accounting, and that states allow some of their required 150 hours to be obtained from internships or similar programs.

The need for specialized technical skills on audits of public companies has never been greater. This trend is likely to increase as our financial system becomes more complex. As such, the need for CPAs with specialized skills in traditional areas like taxation and internal controls, and in newer areas such as valuation, is likely to increase. Professionals who are best suited to

*Testimony of Barry Salzberg
February 4, 2008*

provide such specialized skills may not choose accounting as an undergraduate major. Therefore today's certification requirements may discourage key professionals from entering the profession. We believe that the Advisory Committee should recommend that further study be done on the profession's need for these specialized skills and alternative academic preparation that might allow a wider range of talented individuals to enter the profession.

In addition, although we and other firms have taken a number of steps to address the increasing shortage of accounting faculty (see description of some of the larger firms' efforts at Appendix A), the Advisory Committee could assist by considering a recommendation to ease national accreditation requirements to permit universities to use more adjunct professors and by recommending that each firm with a substantial audit practice commit to provide resources to key schools in the form of adjunct professors. This would allow qualified instruction without the universities risking loss of accreditation.

Because our professionals are the number one asset of the firms, these recommendations to normalize the current license system, improve the immigration system, remove disproportionate independence restrictions, and improve the education and training of accountants, if acted upon, would combine to help ensure the continued strength and sustainability of the profession. In addition, as discussed, the attractiveness of the profession could be even more greatly improved by addressing the sustainability issues facing the profession.

* * * *

Again, thank you for the opportunity to provide our views. This is an important time for the profession, and we commend the Advisory Committee for undertaking this important work. The breadth of issues the Advisory Committee set out in its Working Discussion Outline mirrors those that the profession faces every day. We welcome this opportunity to work with you to find the solutions to these issues that will allow the profession to thrive and continue its role in maintaining the strength and prominence of the U.S. markets. We look forward to reviewing the Advisory Committee's recommendations and would be happy to provide additional information on any of the topics I have covered in this testimony.

EXAMPLES OF EDUCATION SUPPORT FROM THE LARGEST FIRMS

The profession as a whole provides educational support, principally through the AICPA, in the form of scholarships and awards, as well as numerous activities and programs focused on career awareness and outreach, education and curriculum development, and minority and women's initiatives, among others. Details of many of these programs can be found on the web site of the AICPA Accounting Education Center at <http://ceae.aicpa.org/>. An example of these profession-wide initiatives includes the recently announced Future Doctoral Accounting Program of the AICPA Foundation. The Foundation, with funding from the 80 largest accounting firms, intends to address a portion of the issues surrounding the current shortage of academically qualified accounting faculty. The program will encourage universities to increase the current production of PhDs who will teach in the undergraduate and graduate accounting programs by providing a new source of funding for incremental PhD candidates.

The following are examples of education support by the largest firms.

PhD Support

The PhD Project (KPMG) — The PhD Project reaches out to bright, highly motivated minority individuals, encouraging them to consider doctoral studies in business and careers as business professors. KPMG Foundation is the founder, lead sponsor, and administrator of The PhD Project and provides financial support to many PhD students through its minority accounting doctoral scholarships program. Since the Project's inception in 1994, the number of under-represented minority business school professors has increased from 294 to its current high of 889 out of a total of 26,000 business professors nationwide, an increase of nearly 203 percent. And over the next five to six years, more than 400 current minority doctoral students will become faculty members.

xFAC (short for "extreme faculty") (PwC) — Concerned over the high attrition rates in accounting doctoral programs, PwC developed xFAC to refresh interest in Ph.D. studies and to provide an incentive for students to continue in programs. This case study competition is designed to give students in doctoral programs an opportunity to demonstrate their knowledge and communications skills; to provide for interaction between future faculty members and professional issues; and to provide additional funding for the participants.

American Accounting Association (AAA) Mid-Year Doctoral Consortia (KPMG) — KPMG is the sole sponsor of the following four mid-year doctoral consortia: Auditing section, Information Systems section, International section and American Tax Association.

American Accounting Association New Faculty Consortium (EY) — A professional development program for new accounting faculty sponsored by the Ernst & Young Foundation and the AAA. The objective of the New Faculty Consortium is to enhance the scholarship, teaching and overall career development of faculty in early stages of their career.

Deloitte Fellowship Program (Deloitte) — Deloitte LLP, through its Doctoral Fellowship Program, provides financial support to outstanding doctoral students in accounting as they complete their coursework and dissertations. Up to ten students are selected to be Deloitte Fellows each year. Each Fellow receives a grant of \$25,000, disbursed in four payments over two years, to help cover expenses during the final year of coursework and during the subsequent year of writing a dissertation.

J. Michael Cook Doctoral Consortium (Deloitte and AAA) — Advanced doctoral students are provided with a chance to meet with some of the country’s most distinguished faculty in a collegial atmosphere. The Consortium, which has been offered since 1971, focuses on issues that are most pressing to faculty and to students who are about to become professors, including theoretical and applied research, teaching and career development.

Grant Thornton LLP provides financial support for doctoral consortia for AAA sections and in-kind support for the consortia through the participation of PhDs who work for Grant Thornton as well as support for the research and intellectual property platforms of the AAA. In addition, Grant Thornton provides funds and a variety of data collection support for research and an incubator for research concept development through academic research roundtables.

Student Case Study Competitions

xACT and xTAX (PwC) — PwC developed its “extreme games” for accounting and tax to help attract and retain accounting majors. xACT presents challenges that focus on the impact of accounting policy on the business and investing community. xTAX gives students a taste of real world tax policy work. In 2007, over 3000 students (including over 1200 sophomores) from more than 80 universities participated in xACT or xTAX.

National Audit Case Competition Program (KPMG) — New in 2007, the competition requires accounting students to serve on a simulated audit team and receive feedback from an audit partner and mentor in a web-based environment. Select students advance to a national event where they are required to make a presentation of audit findings and answer questions during a simulated audit committee meeting presided over by a panel of judges. Teams from approximately 20 universities were invited to compete in the inaugural competition last spring. For the 2008 competition, 40 universities have been invited to participate.

KPMG /ALPFA Case Study Competition (KPMG) — The firm sponsors the ALPFA student case study competition, which provides finance and accounting students with the opportunity to showcase their business, accounting, research, and presentation skills to a panel of KPMG partners and business leaders of the Latino community. This year 28 colleges and universities attended, with more than 150 students participating in the competition. The students looked at complex accounting problems, identified issues, researched problems, and then presented their solutions to a panel of KPMG and ALPFA judges.

National Student Case Study Seminar (Deloitte) — Through contributions from retired partners, the Deloitte Foundation sponsors an annual National Student Case Study Seminar. Six schools participate each year. Prior to the seminar, a student group works with a faculty adviser and a Deloitte manager to identify issues and develop a plan to research them, develop a solution and

prepare a presentation. The Accounting Services group develops the cases from complex accounting issues that have come through the consultation process. The student groups present their cases and solutions at the national seminar to a panel of partners and faculty who act as a client's senior management or audit committee. The panel raises questions and issues for response and discussion. A group of active and retired partners selects the top groups. A \$1,000 scholarship goes to each student on the winning team, a \$500 scholarship to each second-place-team participant and a \$250 scholarship to all other students.

Tax Case Study Competition (Deloitte) — The Tax Case Study Competition is an educational program that aims to improve the quantity and quality of students pursuing a career in tax. The program, made up of eight regional competitions and a national event, also provides tax faculty with case study materials for use in the classroom and brings broad exposure to tax programs within the university environment. Approximately 100 schools are invited to participate each year. At the national and regional programs, student teams have five hours to complete a complex theoretical case study that requires them to analyze information, identify data issues and consider alternative tax treatments for a fictitious client situation. Each team at the conclusion of the competition prepares a written solution to its case and submits it to a panel of judges for evaluation. All national participants receive financial rewards for themselves and their schools.

Ernst & Young Reel Influence Video Competition (EY) — EY established the Reel Influence Video Competition in 2007 with the goal of facilitating engagement and learning with students and faculty at 77 colleges in the United States. The program encourages students to use their creativity to express themselves and dialogue with EY and faculty about what matters to them. Students form a team and use video to answer the question, "Why Professional Services". EY encourages faculty to participate in team mentoring, and to consider the exercise in classroom discussions. Students have 3 months to submit their video through a custom online portal hosted by EY. Regional and national finalists receive financial rewards, and compete for the opportunity to dialogue with Ernst & Young's CEO.

Faculty Conferences

All of the firms in the global networks support academic conferences including the AAA annual meeting and various AAA section or regional meetings on an ad hoc basis.

Grant Thornton Roundtables (GT) — Grant Thornton provides funds each year for the infrastructure of the AAA's annual conference and the participation of a number of individuals in program planning activities. Academic roundtables conducted through the Grant Thornton Academic Advisory Council bring together academic researchers and Grant Thornton people to develop researchable concepts and hypotheses that will increase accounting and auditing knowledge. In 2007 Grant Thornton was a premier sponsor of the AAA annual conference.

PwC University for Faculty (PwC) — An educational program delivered to faculty from around the country held annually during the summer. The purpose of the program is to provide professors with a current perspective of the profession with technical updates, exposure to PwC training and networking opportunities. In four years, over 1,200 professors have attended this program.

PwC Tax Colloquium and Accounting Symposium (PwC) — These annual programs are sponsored by PricewaterhouseCoopers and precede the AAA meeting. Selected faculty from top colleges and universities from across the country are invited to learn more about PwC and the profession. These one and a half day programs are designed to provide an update for faculty on current regulatory and other developments in the business environment and the profession.

KPMG Faculty Symposiums (KPMG) — Annually the firm sponsors one-and-a-half day symposiums in six regions of the country to update faculty on developments in the accounting profession and business environment. Firm leadership discuss strategies and policy positions on technical issues that span the firm's various practice areas. Educators also learn of programs and materials that are available to them for use in the classroom. Thirty to fifty faculty attend each of the six symposiums annually.

Deloitte LLP/Federation of Schools of Accountancy Faculty Consortium — The objective of the Consortium is to provide faculty with a better understanding of practice issues and to deliver best practice information that participants can incorporate into their institutions' curricula. The program is delivered as a combination of presentations from thought leaders in practice and experienced educators at leading accounting programs.

Tax Faculty Symposium (Deloitte) — Each year the Tax Faculty Symposium exposes about 30 tax professors to the latest technical and business knowledge from our specialists on practice, regulatory and policy issues in taxation. Technical discussions center around various taxation topics, including updates on new legislation, mergers and acquisitions, and estate, gift and international tax matters. Faculty participants also learn about the organization's national tax practice strategy and services and its approach to professional development.

Trueblood Seminars (Deloitte & AAA) — Deloitte professionals re-create actual difficult cases they have encountered in practice. Faculty then propose possible solutions. Other sessions have one group of faculty act as auditors and another as clients. The groups reenact a difficult case and see the challenges from two perspectives. The Seminars are rounded out with guest speakers from the Financial Accounting Standards Board, corporations and other groups in addition to Deloitte. Since 1966, more than 2,000 professors have come away from the Seminars with case materials to use in their classrooms and, often, with ideas for research.

Ernst & Young Tax Educator's Symposium (EY) — Over 60 outstanding tax educators around the country are invited to a two-day technical symposium designed to address complex technical issues, provide curricula materials and connect the professors to some aspects of Tax Policy. During the symposium, the educators hear from leading figures in the tax field, and have the opportunity to form networks that deepen their research and professional development.

Ernst & Young Faculty Dialogue Dinners (EY) — Ernst & Young hosts a series of Dialogue Dinners for influential teaching and research faculty throughout the year. The dinners coincide with the AAA Annual Meeting, some of the AAA Midyear Section Conferences, and the Ernst & Young Tax Educators Symposium. The Dialogue Dinners are hosted for a small group of prominent faculty to convene dialogue on issues important to EY and to the profession.

AAA Executive Committee Strategic Planning Summit (EY) — held each year in June for the immediate past and immediate future members of the Executive Committee. The purpose is to ensure continuity of strategy and execution for the leadership of the AAA. This facilitated session enables the committee members to review the past year and plan the future priorities and activities of the Association.

Academic Research

Business Measurement Case Development and Research Program (KPMG) — KPMG and the University of Illinois established the Business Measurement Case Development and Research Program, which ended last year. The program supported the development of educational materials (17 accounting and auditing cases and teaching notes were developed by research teams comprised of academic and accounting professionals).

PwC INQUIRES (PwC) — PwC initiated this funding program for applied research in the spring of 2007 to assist faculty and PhD students seeking to increase the knowledge base that contributes to the practice of auditing and tax. In the inaugural year, PwC awarded over \$580,000 to 37 researchers. They offer three levels of grants: Micro (\$5,000 to \$15,000), Medium (\$15,001 to \$60,000), and Macro (\$60,001 to \$200,000).

University of Chicago Journal of Accounting Research Conference (KPMG) — The Journal of Accounting Research Conference is an annual event held at the University of Chicago Graduate School of Business. Accounting professors from U.S. and foreign universities submit research papers specific to the topic set by the Call for Papers and four to six papers are chosen to be presented at the conference. The conference is by invitation only and the top scholars in accounting generally attend. The Journal of Accounting Research produces an annual conference issue of the journal comprising of the papers presented at the conference.

University of Illinois Audit Research Conference (KPMG) — First held in 1974, this bi-annual conference is attended by some 50 of the leading academic and practicing members of the accountancy profession to discuss critical auditing issues. The symposium is structured around 5–6 research paper presentations with discussant commentary and questions from the conference participants.

University of Illinois Tax Research Symposium (Deloitte) — A biannual event that aims to stimulate tax research in two ways. First, the program provides an opportunity for tax researchers to expose their ideas and obtain feedback from leading tax researchers. Second, it provides a forum for new and leading researchers to exchange ideas about current issues and research methods. Attendees have included a blend of accomplished authors and leading tax researchers within academia. Representatives of the profession and the Treasury Department have also participated in prior symposia.

University of Kansas Auditing Symposium (Deloitte) — A forum for faculty participants offered since 1976 to review current research and evaluate and suggest topics for future research. Internationally known researchers, practitioners and thought leaders from the public and private sectors participate and share research ideas, methods, techniques and theories.

University of Kansas Center for Auditing Research and Advanced Technology (CARAT) (EY) — A center established to conduct and disseminate state-of-the-art research in auditing and advanced technology that is of value to the academic and professional communities.

Faculty Thought Center Webcasts (EY) — EY invites faculty to its monthly Thought Center web cast series, which focus on significant business issues presented by panels of EY leaders and internationally known industry experts.

In-kind Support

Career Opportunities in Accounting Communications Toolkit (PwC, KPMG, EY, Deloitte) — A "Career Opportunities in Accounting" communications toolkit which includes a series of video vignettes for faculty use in introductory accounting courses, a PowerPoint presentation and a brochure for parents.

Strategic Planning Partnership (EY) — A program of in-kind facilitation services that provided 33 business schools and accounting programs with experienced advisors, a trademarked methodology, and the tools to develop mission-based, strategic plans. A compilation of the processes and plans of several of the schools is available in a casebook, "The Challenge of Change in Business Education." Strategic planning for the AAA's Executive Committee has also been provided by the E&Y Foundation since 1994.

Free Faculty Access to EY Online (EY) — Ernst & Young provides free faculty access to its EY Online tool. EY Online is an online learning portal that provides faculty with customizable access to EY's extensive research library of publications, guidance and whitepapers; the Perspectives gallery, which features EY's points of view on issues that affect business around the world; and provides links to a variety of relevant online resources, such as government agencies, trade associations and regulatory authorities. Through EY Online, faculty can register for news, regulatory alerts and analysis on a variety of topics of interest.

PwC Teaches (PwC) — A new program, developed in response to the shortage of academically-qualified faculty, that puts the firm's active partners on campus to teach credit courses. The firm provides initial "bridge" training, staff support and on-going mentoring. The pilot of this program ran in Fall 2007.

Professors' Resources (GT) — Grant Thornton has initiated a "Professors' Resources" program that will provide user-friendly access to materials drawn from internal training programs on topics of current interest in a format suitable for classroom use.

Faculty Support and Internships

Faculty Support — Each of the major firms provides support for professors through endowments, term professorships and direct support.

Professor in Residence Program (KPMG) — Begun as a program for select tax faculty members to join KPMG's Tax practice as a *Professor in Residence* for a period ranging from three to six months, the program has expanded to provide opportunities for faculty to team with professionals in Audit and Advisory Services practices. Positions are considered in any of the

service areas, depending upon the faculty member's past work experience, teaching and research areas, the time of year, and the KPMG office. If desired, positions can be designed to incorporate experience in more than one of KPMG's Tax practices. The program is intended to provide valuable day-to-day client service experience. Faculty participants are also given the opportunity to attend various training programs including local office training, e-learning, and a five-day national programs for professional staff, taught by university professors and KPMG professionals. Ten faculty members have or are currently participating in the program.

Academic Fellowship Program (GT) — Grant Thornton's Academic Fellowship Program provides an opportunity for select accounting faculty members to join Grant Thornton's corporate governance group for a period ranging from six to twelve months. The academic fellow works on projects within the Corporate Governance Group as well as projects in Assurance, Tax, Business Advisory Services or Economic Advisory Services groups, depending on the fellow's background and interest. The program is intended to provide faculty with first-hand experience in public accounting as well as receive an understanding of practice issues they can incorporate in their own institution's curricula. The academic fellow is also included in various training programs throughout the firm. In addition to fellowships, Grant Thornton also provides a variety of shorter internship opportunities to provide faculty with field experience.

Matching Gifts

Each of the firms from global networks offer a Matching Gifts Program, which encourages U.S. partners (and in some cases retired partners) and employees to support high-quality, innovative education through contributions to colleges and universities. The program provides support to numerous professorships, scholarships, fellowships and more through endowments and direct giving. Contributions are also made in the form of unrestricted gifts, which provide universities with much-needed discretionary funds for academics.

Ernst & Young University Fund (EY) — In 2007 Ernst & Young established the University Fund, an initiative which provides significant investments to schools where EY actively recruits.