

**James R. Doty**  
**Oral History Interview for the Securities and Exchange Commission Historical Society**  
**With Lucy Harvey**  
**April 6, 2021**

Lucy Harvey:

Hi, I'm Lucy Harvey. I'm conducting an oral history for the Securities and Exchange Commission Historical Society. Today I'm talking with James R. Doty, who was General Counsel of the SEC from May, 1990 through December, 1992. And then chairman of the Public Company Accounting Oversight Board from February, 2001 to January, 2018. Today is Tuesday, April 6, 2021 in the COVID time of the plague. Mr. Chairman, thank you so much for joining me.

Jim Doty:

A pleasure, Lucy.

Lucy Harvey:

Excellent. I'd like to start our talk today with a little background on you. And just a little overview of your education. You are Texas born and bred, correct?

Jim Doty:

Correct.

Lucy Harvey:

You started your college career at Rice?

Jim Doty:

Yes.

Lucy Harvey:

And then tell me where you went from there.

Jim Doty:

I left Rice and went up to Oxford in 1962, came down from Oxford in 1964, began pursuing a PhD in modern European history at Harvard. And finished my orals, became EBD, as we say. And many of my friends having gone to law school and I having spent a lot of time with a European history studying the lives of lawyers and thinking that lawyers had exciting lives in the 19th century, I decided to go to law school, and I did. Went to the Yale Law School, came out in 1969, went back to Houston, joined the law firm of Baker Botts in Houston.

Lucy Harvey:

And then you had a brief little interlude at the SEC, tell us about that.

Jim Doty:

It was one of the most rewarding experiences of one's life. Several people described it to me as the best job in Washington--some of my predecessors in the office and others. I had had the good fortune to meet Richard C. Breeden at the time I was back at the firm and had moved up here to Washington. Richard became Chairman of the SEC after the election of George H. W. Bush, and a brief term in the White House as a special issues advisor. So I went over there to see him one evening in October and to meet with him and some of the staff. And it turned out we had selected the day of the market break in Wall Street.

So I ended up staying until two o'clock in the morning. Met a lot of the senior staff; Richard Ketchum, Linda Quinn, Dan Goezler, all of whom became close associates and friends later. Richard invited me to join, and I came as soon as April of 1990, and stayed through 1992, left in January of '93. And really felt it was one of the experiences that you were fortunate to have. I learned a lot. I did not believe I could have been Chairman of the PCAOB without what I learned at the SEC.

Lucy Harvey:

Now, how was it that you came to represent the PCAOB during their Supreme Court challenge?

Jim Doty:

We had just brought to the firm in Washington two talented young alumni of the Solicitor General's office, Jeffrey Lamken and Robert Kry. We had a young appellate practice. I thought this was the case that we should have, it was a wonderful case to be litigating and to take an appeal on. And it turned out that it went all the way to the Supreme Court. And we had the chance to take the case and we did.

Lamken and Kry had analyzed it carefully. And I was unduly optimistic about the results. Being an SEC former general counsel, I thought it was obvious that the PCAOB had the authority that Congress had performed a proper delegation and a young judge in the DC circuit, Judge Brett Kavanaugh [disagreeing with us] wrote a dissent which raised issues that were worthy of a Supreme Court opinion. And so we eventually went all the way up to the Supreme Court. And it was far from an easy resolution. But I had been overconfident, and in thinking that it would be a straightforward case for the Court.

It raised many of the issues that are now there before the Court, and have been there with the Consumer Finance Protection Bureau and will be there again with other federal agencies. And it's an opinion in which Chief Justice John Roberts writing for the Court achieved a majority to uphold the authority of the PCAOB while excising the removal for cause qualification for board members. So it established, I think, a very strong precedent for what the courts will be looking at when Congress performs future delegations in this area.

Lucy Harvey:

What was your path to becoming chairman of the PCAOB then, when you had been on the outset?

Jim Doty:

Well, I would, of course, like to think that the office sought the man, but I can't be sure of that. I felt that it was an important, obviously an important agency. And having met and having known

members of the Board, Charles Niemeir , Steven Harris, Dan Goetzler, it was clear to me that it was a worthwhile, a very worthwhile coda to a law career.

And I think Mary Schapiro and David Becker had been good friends and associates: I had worked with Mary when she was a Commissioner. She was Chair, David was her General Counsel. And as far as I know, they came to me and asked me, would I be interested? And I said, yes, I would be interested. And I was. That's what led to my appointment.

Lucy Harvey:

You have said throughout your tenure at the PCAOB that the audit is the linchpin of the financial markets. So how is it that you came to that conclusion?

Jim Doty:

Practice. My own experience and practice, long association with lawyers who understood the importance of the audit and financial accounting and financial reporting and who were supportive of the independence of auditors. I had had sufficient experience at the SEC to see how significant the audit was in the underpinnings of what became financial disclosure. And then, of course, we had just had Enron, WorldCom and Delphi. So suddenly, you had to focus on Main Street financial reporting, in which the failures of the audit had been at the core of the financial problem, of the financial reporting problem and the collapse of very important issuers [public companies]

It was clear that the PCAOB being created by Congress in that atmosphere was going to have challenges that year-after-year would recur with different emphasis, but nevertheless, the same questions of independence, objectivity, and skepticism--the skill and the craft of the auditors on the account, and very important for the whole process, the engagement partner and the managers, the senior members of the team and the tone from the top that was being set by the firm. And so this was clear to me by the time I got to the PCAOB.

Lucy Harvey:

What were your priorities and how did you set them when you first arrived at the PCAOB?

Jim Doty:

A lot of things had begun to move, change was in the air. I had spent time with Rod Hills and Paul Volcker and some other very knowledgeable people in the context of the American Assembly projects on the future of the audit profession. The commission or the special task force that had been established by the White House had come forward with a proposal that the auditor sign the audit opinion and that had become a point of some contention. We were just beginning I think to see how important the foreign audit was, the participation of other firms.

So for my own development of the priorities of what the audit profession needed and needed to do, there was an initial bias toward better disclosure, more transparency. Much of what I had heard throughout my career and what I heard at the American Assembly project was concern over expectations, the expectation gap, and what Rod Hills used to call the "brittle illusion of exactitude". And clearly the public in Enron and WorldCom, these other financial problems, including the 2008 financial problems on Wall Street, the public had trouble seeing what the audit really was and what it was supposed to be. And it was, in my view, it was important that

the PCAOB start addressing that issue. For me, the most important first step was what we came to call the Transparency Initiative. Identification of the audit and the engagement partner and the manager would seem to be a good idea. Identification of the other firms participating in the audit would be a good idea.

And we came to that through some compromises. The firms had reacted negatively and strongly to the idea of signing the audit opinion. As lawyers, we were accustomed to signing on behalf of our firm. But the audit profession saw this as being a risk that they shouldn't have to take. We moved towards some compromised positions. Eventually, the question would be whether the engagement partner would be part of a disclosure in a filed document under Section 18. That led to reiterations and re-proposals, but we've got to Form AP and the disclosure in a PCAOB form of the engagement partner. And frankly, a fair amount of other very useful information for each public audit.

We also included disclosure of other participating firms, because it became clear we should be looking at this change. (There had been a concept release issued by the time I got there to have the partner sign.) It became clear in this process that there was not full understanding by some people (some of them quite knowledgeable) as to how much the participation of foreign firms was behind the screen, was not transparent.

So we moved further in that area. And with a lot of work having been done on how to modernize the audit reporting model, we came to a formulation of how we would do an expansion and an amplification of the disclosure in the reporting model. There were options there. We could have gone toward an audit, a report on an audit of the MD&A. There were discussions about that, but I think we came to the right result, which is to require the auditor to speak to the critical audit matters, the matters that were particularly difficult, that involved subjective judgments and that were material and that were communicated or required to be communicated to the audit committee.

So that resulted in the audit standard that has now produced several seasons of critical audit matters, with I think, some very good results, not only for the public reading of the report, but also the improvement of internal controls as the audit progresses, as the audit moves through the process. One of the things that we wanted were disclosures that would have a beneficial effect, not only for the public reading, but also on the conduct of the audit. And I think that was achieved with the hard work of very many people at the PCAOB and SEC by the way.

Lucy Harvey:

Absolutely. So auditors reporting model was very big development for you. Can you also describe your proposals for auditor independence and the reaction to your efforts there.

Jim Doty:

Yes. Well, as I said, there were following 2008 strong winds of change. And among those proposals and winds of change was a very strong opinion in some sections that we should do something about the audit firm's engagement term. The Act, Sarbanes Oxley, of course, requires the rotation of the engagement partner. But it was viewed (by some) as being at best a partial remedy, that in the post-2008 era, or given the reality of the client payer model, we needed to consider whether or not engagements should be time-limited, whether firms, whether issuers should not be required periodically to put the audit out for bid.

But this was probably the most controversial event of the period, of the entire time that I was there. Interest in this had been building. There were people who felt it was essential to do it. And there were others who were equally committed that if you did it, it was the end of the independent audit profession. And this is, I'm not glossing, this is in fact, what we were warned and told that if we did it, the independent audit profession would disintegrate.

Europe was headed toward doing it, we knew they were going to do it. It was clear they were going to do it. And so we chose instead to put out a concept release and to ask for comment. We also held hearings. Part of the process revealed that in fact, there were various opinions on the utility and the risks or the benefits of requiring a change in the audit firm every X number of years. But there had not been a disciplined rigorous look at that, that we could find.

And so we held hearings. We called in members of the audit firms, academics, investors. We called in eminent public figures such as Harold Williams and Paul Volcker and Rod Hills, we called a lot of people to come and talk to us about what they thought of this kind of change. It became clear, and in fact, from the concept release, we had indicated that the European approach of a change of the auditors every six years did not appeal. We were really interested in what people thought about terms that extended beyond six years, perhaps 10 years and perhaps with an opportunity to renew.

That actually I think had an effect on the way the Europeans eventually went with their rule. We were moving along nicely with the development of a record and a record which is there by the way and which exists for anyone who wants to look at this in the future. When Congress took a hand and the House of Representatives passed a bill which forbade us from doing this, that forbade us from either imposing term limits on the audit or requiring an audit of MD&A. And so, we of course, always listened to Congress and we moved along.

We had other things to do that we thought we could accomplish that were very important and that we did. But I think the discussion and the debate on term limits of the engagement frames the limits of what is possible now. It is the ultimate way of limiting the effectiveness or the influence of the client payer model.

And for that reason, it may be one of the most important results for the auditing profession to come to in the fullness of time, because I think what we are seeing is increasing dissatisfaction with the fruits of the client payer model, and I don't think we can foresee the government taking over the audit of public companies. What you're now seeing in the UK, for example, is the requirement of a second audit to counterbalance the effect of the large firm that has the major audit, these choices are all difficult.

And none of them are really satisfactory answers. There is no magic solution, in my view, to the client payer model. The preservation of an independent, non-governmental audit is an important part of the free enterprise system. And therefore, what do you need? You need a strong independent public company accounting oversight board, you need inspections, you need what I was told was essential from the day that I began to be interested in this organization, you need to have an organization that has expertise that can push the firms to increase the quality of their audits, keep the pressure on them to do the right thing. And I believe firmly the PCAOB is absolutely critical to maintain the quality of the audit and maintaining the independence of the audit function from a governmental regime.

It's going to be interesting to see what happens in Europe in this regard, but I would just note that the firms I think, to some extent, have gotten religion about this. They would like the PCAOB to

be tractable, to be more of a cheerleader, less of a critic. And in my view, at the time I came to the board, the two most important things were: first, to make the PCAOB respected by the firms and to make the staff or the inspection division respected by the firms; and second, to create the morale within the organization that we were doing important work, and that this was an organization that had strong common sense of mission. If that exists at the PCAOB, the firms will listen, and the firms will, in fact, seek to improve their audit. And that's what's happened.

I think that's what happened in the space of seven years I was there. You could see the firm's objections to the inspection findings plummet, go down. The firms began to take the view that we will remediate, we will do what is necessary to make the Board satisfied that we are addressing our audit problems seriously. That oversight by the PCAOB is essential. If you look at what others see abroad in the PCAOB, you can see how this has developed. Sir John Kingman after the Carrillion fiasco in Great Britain [as the head of a Parliamentary Select Commission on auditing and accounting] came over, he talked to many people here including the firms, went back and wrote a report that said we need in the UK an oversight body that enjoys the independence and the authority that the PCAOB enjoys in the United States. And that of course, that ties to the independent funding of the organization and to its ability to conduct its inspections without influence by the street or the firms, extremely important.

Lucy Harvey:

I'm going to jump in here and ask you about auditor skepticism because you focused on that during your entire tenure. And you said, "Skepticism is a state of mind, objectivity a silent success. Their absence is rarely documented and can be particularly difficult to detect." So that was a very big focus of yours, auditor skepticism. How did that come to be?

Jim Doty:

It arose in the context of the financial collapses that we had seen, the main street collapses. The division of inspections and registration looks hard at the performance of an engagement team. We saw examples in which either the opportunities for fraud were not properly scoped in to the audit, or having been scoped in would be abandoned under the pressures of time of completion of the audit. These are the enemies of skepticism, looking for disconfirming information is hard. And the auditor to do that runs the risk of rubbing management and the middle management the wrong way. But it's essential.

We know from psychology that we would prefer to find evidence that reinforces what we already believe. This is not heretical. In fact, we would be naive to think that being hired by and paid by the management and needing to preserve the relationship of a major client, the auditors don't, in fact want to find that the issuer's financial reporting is sustained by the facts, by the books and records of a company properly kept. To press that point home and to press management on that point and to in fact find areas where it fails is a very hard thing. And it requires an attitude of zeal or a sense of commitment to your profession that transcends, goes beyond the limits of the particular engagement. As an auditor, as an engagement partner or manager, or young auditor, you carry the firm's reputation with you in the audit.

It's a very hard thing for a young auditor to bring to the attention of a manager and for the management to take up the line. And for the engagement partner to take into the C-suite or the board room the view that the books have not been properly kept. But unless the auditor looks for it, and unless the auditor is thinking we have got to find it [disconfirming evidence]. We've got to

test the system. (These are now largely system-based records.) The auditors have to be able to be forthright in testing those systems, especially among companies that are global, that have many, many business locations that have grown by acquisitions rapidly in the past.

There are in other words, red flags, there are circumstances of the auditee, of the issuer that require the auditor to scope in the real risk of fraud. At times, we hear the members of the audit profession saying we are not obliged to look for or to find fraud. They do themselves a disservice as they did themselves a disservice by saying we don't want you to know who our engagement partner is, or we don't want you to know how many other firms participated in the audit. That is not good for confidence in the audit. And for them to say we don't look for fraud is also not consistent with the auditing standards, with their responsibility, and it is not consistent with good audit practice. So skepticism is what drives that. Without a streak of skepticism, perhaps one is not suited to be an auditor or a lawyer if you have no instinct for skepticism about what you're being told.

Lucy Harvey:

In 2008, the discovery of the Bernard Madoff Ponzi scheme, \$65 billion Ponzi scheme gave the PCAOB the authority over the audit of non public broker dealers audits. And so what did the PCAOB that was, just as you were coming on, the PCAOB had this huge new authority and were they up to the task and what did they need to do to get that program up and running?

Jim Doty:

Of course, they were up to the task. The PCAOB is always up to the task. They knew audits of broker dealers. They had audited major financial service holding companies. So they knew something about how the brokerage industry will structure and what the audits looked like under SEC accounting standards, to produce the accounting statements, the SEC required. The accounting statements were required by the Commission. And the auditing standards follow those.

The Board is directed by the statute. If it chooses to inspect the audits of certain broker dealers to go do that. If it chooses to consider different rules for different inspection schedules, it can choose to institute programs, schedules for the brokerage industry, depending on the complexity of the brokerage business. Congress essentially tossed to the PCAOB the most difficult questions, which were how is an industry as diverse and as fragmented with the ease of entry of the brokerage industry, and with as many different business patterns, how is the audit best imposed on that business model?

And the PCAOB did exactly what it should have done, I think: we established a task force, Helen Munter and Bob Maday went out to collect the information about different strata, different forms of business in the brokerage industry that we would need to be able to evaluate the other questions that Congress had given us, which is what should be the schedule for audits? What should be the program for audits? And what kind of exemptions, if any, should be granted? These were not simple questions, they required looking at a great diversity of firms. But the PCAOB did the one thing which Congress said they wanted us to do. We made reports, we made annual reports.

And those reports, I think educated many people on how diverse that industry was and what it looked like. We had an interim program of inspections we thought about carefully and seriously. What we should be looking at for an auditor that was not receiving customer funds, that was

simply advising the customer and the clearing house and another clearing firm on transactions. We had a different set of facts involving firms that did receive client funds, but promptly transmitted them overnight as the statute, as the Exchange Act requires, to a registered depository

And that, of course, was the key to the fault lines, the differences, the different firms in this industry had. The firms that were full service, major banking institutions, affiliates and had had the audit, had been part of a major financial institutions reporting system. Those audits tended to be the better audits. The audits that were the most questionable tended to be firms that were leaving, in some cases, the business. Audit firms leaving the business or brokerage firms leaving the business. So this was a time of rapid consolidation in the brokerage industry. That'd been going on for some time.

So real questions existed as to whether there should be exemptions. We never resolved that issue. It became difficult to look at where an exemption should be granted. There were people who thought if you were "mere introducing broker, a finder," you should not have to comply with any of the audit requirements. Very difficult to justify that in light of what was seen as going on in the industry.

Independence problems are a problem, were a problem for the auditors of smaller brokerage houses, who often require the auditor to help prepare the books. The best result in that case did not have the clarity that the Transparency Release or the audit report model or any of the other rules that we adopted did. Well, we never got around to promulgating a final set of audit inspection-schedule standards [or exemptions therefrom]. We did not want to do harm. We did want to enforce the law and uphold the law. We did that when we saw enforcement issues, independence issues in the inspections of these firms, and we inspected a large number of firms. We inspected freely. We got the resources to do the inspections in our budget. And when we found those problems, we referred them.

Lucy Harvey:

It had been a little bit of a wild west.

Jim Doty:

Yes, of course Madoff's problem was that his brother in law was the auditor and was in on the fraud. So deliberate fraud connived in by the auditor is a different order of problem. But if you have to undergo a PCAOB inspection, you should not be engaging in practices that enable the audit client or the broker dealer to engage in fraud. If you're not registered, or if you're not conducting an adequate audit, you will be in trouble, you will hear from the PCAOB.

Lucy Harvey:

And that's in fact what happened, very much. You were very interested in improving auditor communication with audit committees. Why was that one of your priorities?

Jim Doty:

I had seen that so clearly in practice. The FCPA, the Foreign Corrupt Practices Act, the breakdown in derivative accounting at Freddie Mac. So many of these areas which resulted in large scale costly problems for corporations and the ruin of careers by legal consequences. So



many of these had to do with inadequate communication and inadequate follow up in the boardroom. When I came on, the standard AS 18 (I think) was well along. And it was a good standard. It was the first one we were able to adopt while I was there. But it seemed to me to be absolutely spot on for something that would in fact improve the role of the auditor, and the visibility of the auditor where he needed to be visible, which is in the boardroom. But also it was a basic start on the audit reporting model and cams.

The audit firms, of course, being large, the major firms, the four major firms, large political organizations present their senior management with political challenges. It seemed to me that it was important for the PCAOB to be making clear to the rank and file of these firms that when management says you've got to get on board with standards such AS 18, there was a reason for that, that they meant it and that it was in fact, proof that management was not simply speaking, giving voice to a principle that it didn't need to support. That in fact, we were going to be pushing hard for management to show that they were working to make the audit and the firm top to bottom a place of higher audit quality.

AS 18 was an important part of that, remains an important part of it. We've seen examples. We still see examples in which clearly in the Wall Street Journal and The Financial Times around the world, the communication has not been where it should be in, has broken down.

Lucy Harvey:

Another one of your big pushes was the creation of the PCAOB Center for Economic Analysis. So tell me what was behind that effort.

Jim Doty:

Bias, a personal bias toward what the academy can offer the real world. I was not an economist, did not study economics, but in the study of the history of the 18th century, of the 19th century, and Britain in the 18th century and much of Europe, you could see how important political economy had been to what I would call progress. The cost benefit rules, and the interest of Congress and the courts in cost benefit analysis was not going to go away. And in fact, I remember a discussion that David Becker and I had when he was General Counsel down at SMU when the question was mooted, seriously, was the focus on cost benefit analysis going to bring meaningful and useful financial services regulation to a halt?

David and I, neither one of us I believe, concluded that it would, but the question was, why not? What did it mean to say that you have to have economic analysis? And it was clear that the courts were taking a harder look at this. They were not so persuaded. They were not persuaded that, in fact, what the administrative agencies were doing, in that regard, amounted to the serious analysis that should happen.

I had met through the contacts with Gordon Seymour and Sam Ross and Charlie Niemeier, other people who had done been so valuable on this, I had met Christian Leutz out at the University of Chicago, and some of the other people in this area, and we went out there. I had pulled some years earlier a book called Saving Capitalism from the Capitalists by a young scholar named Luigi Zingales.

And I hadn't read it, of course, I had shelved it. And suddenly, my counsel, Sam Ross said that you need to read this. And so I pulled it and read it. And it was a wonderful thing to have in your hands, something that was telling you where you should go with the programs of the PCAOB. So

we went out and we met Luigi, and he turned out to be a great find for us. And he became the founding director. And eventually he and Christian and others recruited people for us as fellows. One of them, one of the most recent, Preeti Choudhary is now coming east, again, having been a distinguished professor in Arizona.

We have others who are in academic positions now having been in the Center who have written me notes. The greatest source of satisfaction that I have had being the notes and the wishes, the well wishes and to see where some of the alumni of the Center for Economic Analysis have ended up. And many of them are now in very important faculty positions. But after working with this for a while, we eventually got to the office of Economic and Risk Analysis.

And it is a full-fledged office in the PCAOB. It has fellows and permanent staff. And if you go back and look at the adopting releases and the proposing releases for the audit reporting model, the transparency release, disclosure by the auditors of how long they have been the auditors in the audit reporting model, disclosure of other firms and the other participating firms. If you go back and look at those releases, you can see the maturation of the economic thought that goes into it. You can see an increase in the level of, I would say the level of scholarly sophistication and validation of the things that the administrative body, that the organization is actually considering and should be considering in the area of adopting auditing standards

Also I think the SEC was a great help to us, by the way, and assisting in getting this started. The Division of Economic and Risk Analysis there was useful as model, it was very helpful to us and useful, they worked hard on our behalf and helping us get started. And we've done this in financial services regulation. So why not in other areas? I mean, clearly, when we started this process, people looked at the Fed. And they said, well, the Fed has this kind of economic analysis. That's why at one point, people were suggesting that the SEC should be more like the Fed, maybe part of the Fed.

The fact of the matter is that we're in an era now in which [this will be the standard]. I don't think financial services regulators, the Treasury, the Fed [are unique in mastering economic analysis]. I don't want to irritate the members of the Treasury or members of the Fed here. There are also other organizations I'm sure, [such as]the FDIC, who have many, many talented economists. But it is a fact that I think we have successfully integrated economic analysis in the work of audit regulation, audit oversight, and federal securities regulation.

Lucy Harvey:

And it's proved very beneficial.

Jim Doty:

Yes.

Lucy Harvey:

You also made a very big effort to an outreach to foreign, your foreign counterparts, foreign regulators. In 2011, you were named statesman of the Year by the Foreign Policy Association. So why was it so important to you to have this foreign outreach?

Jim Doty:

I think I owe the Foreign Policy Association [award] to Paul Volcker, who became a great friend, and was a great resource and a strong support for the PCAOB. But we had begun, as I said earlier, to see how much of the audit resided abroad. Originally, the PCAOB had good introit, good access into European audits. The Article Six Directive of the EU changed that. We were not allowed to go [do inspections there] abroad, until there was a determination of adequacy. We gained that determination again in 2013. Through this effort you have described of reaching out to regulators and including the EU Commissioner, Michel Barnier, we received a six-year extension of the adequacy determination.

And that really gave us the ability to move faster in getting access to foreign audits. And we brought European and Asian regulators here. So it was very much a two way street. Europe, South America, much of Asia. China, of course, was the big exception and remains the big exception there. And I think, part of what we were doing, we were in fact making China an outlier in this area of inspections, of in country inspections, in which both we and the foreign regulator would go in and conduct an inspection. They doing the work that they could do, we had enjoyed always very close relationships with Canada. And we had begun to rely on the Canadian CPAB, Canadian Public Auditing Board for parts of the inspection.

We had similarly close relationships with the UK. Those resumed when we got the adequacy determination. France, we worked hard, we got good access such that we had great relations with France and the same with Germany. So we then moved to Spain, Italy and the other parts of the EU became accustomed to seeing us. Japan, we had always had close relations with the Japanese regulator, and continued to do that, continued to enjoy that.

So in fact, this was the continuation of something that had begun well before I got there. And we were fortunate that we were able to move it farther and faster. By the time I left, we were in inspecting in 30 countries over 90 firms. And frankly, I think the transparency release, and the identification of the foreign participants in the audit made that entire process more critical.

Lucy Harvey:

You really conducted a Herculean effort to get into China and to get an agreement to see the audit work papers of Chinese firms. Tell us that story.

Jim Doty:

The SEC, by the way, had done a lot of work. While I was General Counsel, we went over to China. We brought our ethics rules to the CSRC, the China Securities Regulatory Commission. In the work of the Office of International Affairs I had known and worked closely with Michael Mann and the others there in the Breeden Commission. That was something of a pattern. We had that experience to follow in all these dealings with foreign regulators. And we had a basis for dealing with the Chinese. We had some knowledge of what they did.

The Chinese audit profession was young, still is, and is regulated by the CSRC. So it seemed that we should be able to do this. Sovereignty and issues of territoriality were raised. And we eventually, through the hard work of some very brilliant people, Bruce Wilson, Lisa Hunt, a young lawyer named Alan Lo Re who started out in enforcement and moved over to the international side and some other people, all this got us into China to be able to do some of that work. And in the report to President Trump by Chairman Clayton and Secretary Mnuchin, there's a letter from the current PCAOB Chairman that describes in detail how this work has gone forward and how it has been frustrated by the Chinese.

The problem with China has always been that you didn't know how far the people you were dealing with could go, beginning with the CSRC. Throughout my chairmanship. We would succeed in establishing good working relationships with individual officials at the CRRC. And that certainly was true in the Strategic and Economic Dialogue of which there were two when I was Chairman ( we went to the economic side of that twice).

We seem to be moving forward, we did in fact, get a pilot program. The pilot program was intended to allow us to inspect a Beijing based accounting affiliate of a U.S. firm, we did that. It was to lead to a subsequent inspection of the Hong Kong based affiliate of a major firm but that was shut down, did not go forward

Always, with China there's a step forward and two steps back. And that was very much our experience. We would be dealing with people who understood because they had U.S. Wall Street and banking and regulatory experience, who understood what we were trying to accomplish. That we had to sell people in China on the idea that we were not looking at the internal documents of state owned corporations that were in the defense business, that we were just looking at what the auditors had already seen. That in fact, we were just checking the checkers in this sense to determine whether or not they had looked at anything and what they had looked at and what they might have asked for that they didn't look at.

All this gets to be extremely techie when you're dealing with a with our own audit oversight system. When you're dealing with the Chinese and only Mandarin can be spoken in a meeting, it becomes very difficult. But I think eventually, the Chinese simply abandoned the process that would have enabled them to say to the last administration, to the Trump administration, "Look what we're doing with your audit regulator." They abandoned that at precisely the time when it might have been useful to them. But who are we to say what they might see as useful to them.

The fact is, as the letter from the PCAOB to the administration shows they have been very difficult to deal with. And you never know whether if you have made progress on MOU, on enforcement, our progress on a pilot program, on inspections, you never know whether or not it will be implemented or can be. And this is a problem of dealing with non-transparent authoritarian regimes.

Lucy Harvey

Yes. You were a Rhodes Scholar, and you read history at Oxford. And you have said that Oxford was hard to shake off, my history lessons traveled with me. And your speeches are sprinkled with the most interesting references to Napoleonic code and Conquistadores and the Dutch West Indies company and other early adventurers who are trying to finance a high risk trading operations across wide oceans. So I wanted to know, did you engage in this history of the early corporation as part of your studies? Or did you get involved as a young securities lawyer? And you certainly did use it as you wrapped up your career at the PCAOB, didn't you?

Jim Doty:

Well, I wish that I could claim to have gone back and found each of those references on my own, but I did not. In my legal counsel, Samantha Ross, I also had a wonderful speechwriter. But the interest in the economic history of Europe was begun at Oxford. That's where I met, encountered intellectually R.H. Tawney, and many people who were important in the early 20th century, in thinking about who we were and what our economy was.

And that's what I meant, that it carries with you. I think, my interest in going to law school came from that, I had at Harvard, one time, in my brief encounter with a PhD program, I had gotten into the Encumbered Estates Act, which is a very arcane area. I do not intend to talk at length about that here, except to say that it is one of several examples in which the British Crown in Ireland tried to do the right thing and went badly wrong.

You can see in history so many examples of our central planning or central, the use of economic theory goes wrong. And that does give you I think, some skepticism, and it builds in some sense of restraint and what can be accomplished. And all I can say is I found it comforting at times that the problems we were having, such as dealing with a fractionalized brokerage industry, in which Bernie Madoff had prospered, that these were not problems that people hadn't encountered before. That there was nothing unusual about the fact that in a complicated economic society, you had to deal with very technical nitty gritty issues like this, and without clear answers.

Lucy Harvey:

It was during your tenure at the PCAOB that the first part two inspection report was released, and that's the inspection report for an annual inspected firm who did not remediate significant quality control concerns. So that was during your tenure. It was the part two of Deloitte's 2008, and it was released within the first year that you were at the PCAOB. Describe that kind of big event and how you prepared for it and what the ramifications of it were.

Jim Doty:

It had been a source of great concern to the Board that they couldn't get this done without long and protracted litigation. And it is part of the problem of the statute that delay is at times built in. We'll talk more about this before we adjourn. But the fact delay is not in the interest of serving the purposes of the Sarbanes-Oxley Act. Delay inhibits disclosure and reaction time, it inhibits the advice that firms need and the action they need to take.

The Board had been working with this [problem]. And I think they were close. We hit upon the idea that maybe if they were not the only firm to go forward, that the existing quality control issues and the other major firms could be handled as well. And by sort of working through it, working with the firm heads, we hit on something with a solution. And that is that the firms, all of them, the other firms would agree that they would allow their reports to come out if we would allow them to attach a letter that says, we take audit quality very seriously and we're going to do something about this.

And I think that was something of a break in the ice. It was in part coincident with changes in firm leadership. And I think, as I said before, we wanted to make the firms sure that we were serious, and that they had to work with the staff, they had to honor what they knew to be legitimate objections by the staff and legitimate findings. All of this was accumulating in the mix, along with all the possibility that we might order the issuers to change auditors every 10 years, along with the fact that we might require audit partners, engagement partners personally to sign the audit report. So all of this was going forward.

I think once they knew that we were going to do some things, then some of these things became less sure as a firebreak for them. I mean, I think they began to see that with Sarbanes-Oxley having been adopted because of Enron, WorldCom and Delphi, and then having come through the 2008 financial collapse. I think there was a proper sense that the ice was a bit thin. And that we needed a new tone in dealing with the PCAOB. That's what they told us

They said to us in so many ways, we're not going to have our auditors requiring us to defend to the bitter end their objections to all of your findings. And after trying, I think, what they thought they could have effectively tried to block this. I think they came to the conclusion that look, it's better not to appeal it, not to prolong it, it's better to convince the public that this is a problem that we have surmounted, that we're getting beyond this stage. It's what they said and it's what they did.

The reports issued, the Deloitte report [had] issued, followed promptly by three other Part Two Reports on major audit firms with the caveat that each of the firms are saying yes, we're agreeing that this can become public. But we do not intend to allow the public to think that we're not attending to audit quality, we will be attending to audit quality. It was a process.

Lucy Harvey:

Yes. You also fought against the effort to keep disciplinary proceedings confidential, which is, of course, one of that was within the statute that was something you really didn't have control over. But you fought against that, talk again, why?

Jim Doty:

I think first, the opinion was very strong at the Board that we did not really have the authority to release our file charges and to release other information that we had. And before I came to the Board, there had been a very strong speech by our Enforcement Director Claudius Modesti about the fact that this was an inhibitor that the firms shouldn't object to this. It is part of the statute. And I had the view when I came that I was not sure how much of an inhibitor it was. But when I came, there were some cases that I became aware of, I learned about, in which firms had litigated for years, raced out and gobbled up as many other engagements as they could and performed the same bad audit on those engagements.

Some firms were telling issuer clients, don't worry about the PCAOB, don't worry about these charges, we'll bottle those up, the public will never hear about them. So there were two things about it. One, it was the agent of delay that I've spoken about that really inhibits the process of making audit better. But the second thing was that as a lawyer, who had been advising clients, issuers and at times, auditors, it did not sit well that the people who were supposed to be counselling issuers about relations with their auditors and what they should worry about in dealing with their auditors in what they should be doing or not doing, it did not sit well that all these advisors would be ignorant of what some audit firms had done and we're doing

It seemed to me the charges as filed should be public. I still believe it. I think that the settlement process will be more efficient, it will not be undercut or rendered meaningless. I think the firms would be benefited by getting these cases behind them instead of having a partner or a manager protract litigation for a long period of time. Sometimes I think at the firm's expense. So I think it would be better all around if when the PCAOB decided that an auditor should be sued, that they could disclose that, that they could make a litigation release about that just the way the SEC does with respect to their lawsuits and every other litigating federal agency, the FDIC for example

The speed with which things settle may reflect some progress in this area, the PCAOB this week, recently announced sanctions against an auditor, Brazilian auditor being unregistered and not performing the work they should do. The Division has been very effective in taking the enforcement message to the jurisdictions which may not be as respectful of honest financial

reporting as our own. And so, there may be, I think cultural differences have made a difference in the way that some jurisdictions have viewed the audit. Problem with China.

Lucy Harvey:

On your watch, the PCAOB turned 10. And there are some who feel that you really put it on the ecosystem have made the PCAOB a player in the ecosystem of financial regulation. And do you think you succeeded there? And if so, how did you do that?

Jim Doty:

Well, anyone who said that is being very kind. The PCAOB, I was told by Mark Olson, the late Mark Olson, before I joined it, that there was a wonderful staff and a great esprit de corps among the staff, I found that to be true. It's a great organization. I feel privileged to have been able to be its Chairman. As I said, at the time I came, I felt it was paramount that the firms knew that we were going to push them to improve, that we wanted them that they had better respect the PCAOB and its auditors, that it wouldn't do for them to complain to others that our findings were merely technical lapses. And that, in fact, they were not fair.

All I think with good results for the firms as well as for public confidence in the audit and the PCAOB. I wanted the PCAOB to be respected. I wanted the staff to be respected. And I wanted a sense of mission. And I think if you persuade the staff that that is your lodestar, you're going to be all right, your organization is going to perform well. If you have told them that they are not to eschew risk, that there are times when risk is warranted. And if risk is well taken, if it's taken for the proper purpose, and with proper consideration of the risk, if it doesn't turn out well, you will back them up.

So I think the organization did wonderful things while I was there. And whether it's standard setting or inspections or enforcement or economic analysis, whatever you're looking at, I think these were the result of a staff that knew that they were being encouraged to go out and think of what they could do to make it a better place and to make it a more respected organization. And I don't think there's anything unusual about that pattern.

Lucy Harvey:

There's always been a natural tension with the SEC, who has of course, the oversight authority over the PCAOB. What was your experience?

Jim Doty:

Yes, there was tension. And I refer to this as creative tension. The statute establishes it as oversight authority. The meaning of those provisions and the extent to which they're employed, I think are a matter and should be a matter of some interpretation, some thought, some review from time to time. Early on, I think the firms liked to go immediately to the Chief Accountant's Office and to say you'll never guess what they're doing at the PCAOB and [complain that] the inspection findings were mere trivia, and these are not good. I think that's a practice that you can expect. It wouldn't surprise anyone that they would try to go over your head if you were doing things they didn't like, and they did.

But I was there for seven years. I was not removed. I was there actually for three years after my term expired. I think the firms were no less vociferous in the last three years than they were in

the first three, about the fact that they wanted a different kind of PCAOB. But I thought our relations with the SEC were always correct. And we enjoyed always good treatment in the budget hearings. The test, really, of how things sit between the PCAOB and the SEC can be read in the budget hearings. Then the Chairman of the PCAOB sits there with the Chief Accountant and with the business, the Chief of Operations and the SEC, and reports to the Commission and talks to them and receives their questions.

And those were always, I think, those were good meetings, they were well attended. They were thoughtful. I think that the PCAOB is well served by being able to sit in front of the Commission with the Chief Accountant and the SEC Administrative Officer and talk about what has happened over the last year, and what they expect to have happen. There are questions that come from the Chair and the Commissioners about what they want the PCAOB to do or to do more, to do faster. Are we going to see a permanent set of standards on inspection schedule of broker dealers, for example, came up from time to time.

But it gives the PCAOB a chance to discuss with the Commissioners in front of the Chief Accountant and with everyone there how we see things. And I thought those were wonderful meetings. I believe that it would be well served for the Commission not to involve the professional accounting fellows of the SEC in the actual substantive work of developing the auditing standards that eventually will be applied to the professional accounting fellows when they go back to the profession. That's something that could be done, it would be easily done.

I think the more the PCAOB is reporting to the Chief Administrative Officer of the SEC, and directly to the Commission, the better the Commission is served. And frankly, the better it is for the Chief Accountant and the performance of their highly specialized mission, which is to advise the Commission on novel questions of accounting disclosure, and to tell the public about that. So there's no doubt the oversight is there, I do not think the PCAOB would want to say we have no responsibility to the Commission to keep them informed fully. And it was always, in the budget hearings and the budget process, which is a very exacting process, it was always useful to know that we had had a lot of discussions with the SEC's staff before we went before the Commission.

Lucy Harvey:

What do you think is your legacy at the PCAOB?

Jim Doty:

With age and I hope experience I have become mistrustful of legacy-- one can never know. I do think it is a mistake if you're in the position of leadership of an organization to have your personal legacy become a determining factor in your decisional process. You have to listen to too many people. You've got to reconcile a lot of points of view. You should keep your focus on what is in the public interest and what's best for that organization at that time in performing its mission.

And maybe you don't have a legacy. I mean, sometimes events move so fast, and things change so completely that you simply fade from memory. The SEC Historical Association is here because I think many of the people who work so hard and so valiantly over years at the SEC realize that the rapid change, the transformation of our capital markets and everything that's going on will mean that at some point their preoccupations will seem quaint and unimportant. And in fact, some of the things they did will seem to be mere footnotes. So I'm not a big believer that one can know a legacy or one should be spending much time thinking about it.



Lucy Harvey:

Well, all right, Mr. Chairman, this was delightful. Thank you so much for sharing all of your insight with us.

Jim Doty:

I hope it was not too verbose. The problem with former chairman is the verbosity bias.