

# AGENDA

## ‘Something Rotten’ — Are Auditors Too Cozy With Boards?

By Jennifer Williams-Alvarez March 5, 2021

“Do your job ... but not too well.”

This is the sentiment that allegedly prevailed at **PwC**, according to claims stemming from ongoing litigation brought by former employee **Mauro Botta**, who claims he was fired in 2017 in retaliation for blowing the whistle about questionable auditing practices. Among them, according to Botta, is that PwC would pull punches in public company audits in order to maintain a positive relationship with clients.

Botta “did not cave to internal pressure at PwC when he was told repeatedly to do his job — but not too well,” his attorney, **Alexander Cabeceiras**, argued as the trial opened last week. “When people invest in these publicly traded companies backed by PwC and other major auditing firms, whose goal is not independence ... but whose goal is to keep the client happy, people suffer.”

Botta’s claims highlight a source of long-standing criticism about the cozy relationship that can develop between auditors and public companies, one that may lead the former to go easy on the latter when conducting an audit, sources say.

“This case seems to me to be diagnostic of a much deeper problem,” says **Don Moore**, a professor at **UC Berkeley**’s Haas School of Business who has studied auditor independence. “When auditors rely on the favor of companies that they’re auditing, it’s basically asking them to bite the hand that feeds them when it comes to reporting inadequate accounting controls.”

Moore adds, “There’s something rotten at the heart of the way that corporations are audited in the U.S. and around the world.”

### Interference?

Botta started at PwC in Italy in 1999 before transferring to the office in San Jose, Calif., in 2004. More than a decade later, in 2012, he was brought in as a senior manager to work on audits for PwC client and semiconductor company Cavium. After three years on the account, Botta raised concerns about internal controls at the company, which was acquired by **Marvell Technology Group** in 2018. Cavium had failed to disclose that it had fallen victim to a phishing scheme and had wired \$400,000 to an overseas bank account, for one, Botta testified last week. There appeared to

be a level of incompetency at Cavium and a lack of internal controls that in the aggregate amounted to a material weakness, which Botta said prompted him to draft a memo outlining his concerns to the engagement partner on the audit, **Tye Thorson**.

It was not ultimately determined that there were material weaknesses at Cavium, which must be reported in regulatory filings, and Botta was removed from the account. As Botta tells it, he was taken off the account for following protocol. Management at Cavium had a problem with his probing questions and requested he be taken off, which Botta described as “improper” during the trial.

As long as an audit team does the job assigned, according to Botta, “companies should not interfere with that decision,” he said, referring to the professionals staffed on an audit. “To me, it does not seem to be very independent,” he said.

From PwC’s perspective, however, problems arose soon after Botta joined the Cavium audit in 2012.

Cavium’s then-chief financial officer, **Arthur Chadwick**, approached Thorson the same year Botta joined the team, Thorson told U.S. District Magistrate Judge **Alex Tse** this week. Cavium was not “warming up to” Botta’s bedside manner, Thorson recalled, but he requested they keep Botta on at least another year.

“My view is he was a little bit like kind of a fine wine, where it takes a little bit to get used to him,” Thorson said. “We don’t do what our clients ask or tell us to do without thinking about it, considering it and weighing a lot of different options,” Thorson explained later in the trial.

Botta was taken off the account in 2015, as complaints from Cavium continued.

The second audit central to Botta’s litigation involves California technology company **Harmonic**, which has a \$785 million market cap currently. Botta said he became “deeply” concerned about the company’s financials soon after joining the audit in 2015. He began asking the company for documents and raised questions, actions that were met with a warning from **Stig Haavardtun**, the partner on that audit. Haavardtun told Botta to “be careful” because there were important individuals sitting on the Harmonic board, including a director from **Wells Fargo & Company**. (Harmonic director **Susan Swenson** previously sat on the Wells Fargo board.)

This was a “significant concern,” Botta described, because “to me it is irrelevant who sits on whose boards; the audit process does not change because of that.”

During the trial, Haavardtun recalled events differently.

Similar to the Cavium audit, Haavardtun said, Harmonic management did not get on well with Botta. Botta asked too many questions, Harmonic’s former corporate controller, **Gregg Lakritz**, relayed to Haavardtun. During the trial, Haavardtun testified that he told Lakritz it was good that Botta was raising issues.

Still, concerns remained, and Harmonic asked that Botta be taken off the audit in early 2016. Haavardtun refused, he testified. Botta was, however, finally taken off the audit in March 2016.

As for the Wells Fargo mention, Haavardtun said it was an attempt to get Botta to take the audit “seriously.”

“I felt he thought of Harmonic as sort of a smaller client ... and I used the example to try to see if I could get him to ... be as respectful as I wanted him to be.”

Material weaknesses were also not ultimately found at Harmonic.

Botta filed a whistleblower complaint with the **Securities and Exchange Commission** in November 2016, alleging that he was retaliated against for raising red flags about PwC audits. The SEC did not bring any enforcement action in response to Botta’s complaint. Botta was terminated in August 2017 but not for speaking up, according to PwC.

“PwC terminated Mr. Botta for violating both firm policy and professional standards after he stated twice that he fabricated an internal control and falsified audit documentation on a PwC audit client engagement,” PwC shared in an e-mail statement to *Agenda*.

“The testimony and evidence presented at the trial has proven that PwC took Mr. Botta’s claims seriously and, in consultation with its National Office, reached the correct conclusion on each of the audits at issue,” the statement reads.

Cavium parent Marvell Technology did not respond to a request for comment. Harmonic declined to comment.

### ‘Undercurrent of Potential Bias’

Overall, Botta enjoyed working at PwC, he testified. And in fact, one of the aims of his suit is to be reinstated at the firm. One aspect he disliked about it, however, was the relationship between PwC and clients. The purpose of doing audits was sometimes “subordinate” to commercial and business concerns, such as keeping corporate management happy because they were the ones paying the bills, he said.

Having both Cavium and Harmonic on PwC’s client roster brought in millions of dollars for the firm, SEC filings reveal. In the five years before Cavium was acquired by Marvell, audit fees collectively amounted to roughly \$9.8 million. At Harmonic, which switched audit firms in 2018, the fees for the five years before the change come to around \$11.6 million.

The closeness between audit firms and companies has been a source of perennial criticism and concern.

In 2016, for example, two former **EY** partners were central to SEC charges that auditor independence rules had been violated. In one instance, former EY partner **Gregory Bednar** had an “inappropriate” relationship with the CFO of a public company client. Bednar took the CFO and his

family on at least seven trips and treated them to sought-after tickets to sporting events, according to the SEC. In another circumstance described by the SEC, ex-EY partner **Pamela Hartford** had a romantic relationship with a public company client while on the auditing team for that company, which *The Wall Street Journal* reported to be **Ventas**.

EY agreed to pay \$9.3 million to settle the matter without admitting to or denying the charges.

At the same time, regulators in the U.S. have loosened auditor independence rules. Late last year, the SEC adopted amendments to its rules to allow for certain relationships that in the past would have triggered violations of the rules. The following month, the **Public Company Accounting Oversight Board** similarly announced changes to its independence standards to “align” with the SEC’s revisions.

Former PCAOB board member **J. Robert Brown Jr.**, who lambasted the PCAOB last October for falling short on its promises, criticized the audit overseer for rushing to change audit independence rules. The PCAOB, he said, went against customary practice in not inviting public comment and moved forward without doing an economic or policy analysis of the changes.

“The hurried nature of these actions also means that the Board is not adequately considering the impact of these changes on audit committees and on its own role in auditor oversight, a failure that will likely generate confusion and uncertainty in its wake,” he said in a November 2020 statement. “Audit committees oversee auditor independence. There may be no more important task assigned to these directors,” added Brown, who left the PCAOB early this year.

Intense criticism continues about perceived audit failures, says **Robert Cox**, a former assistant director in the PCAOB’s division of enforcement and investigations, pointing to EY’s audits of failed German payments company **Wirecard** as one example. The type of “chumminess” alleged by Botta, if true, is the exception rather than the rule, though, says Cox, a partner at law firm **Briglia Hundley**.

“However, I think that, just the way the relationship exists, there’s always going to be some undercurrent of potential bias or overly close relationship occurring between the auditor and audit client,” Cox notes.

Some developments, such as partner rotation every half decade as required by Sarbanes-Oxley, are improvements, but Cox says “radical” changes are required to completely alleviate ongoing concerns about independence. That could include audit firm, rather than solely partner, rotation, he notes. The change in administration and the expected confirmation of **Gary Gensler** as SEC chairman could bring about some shifts, but for now, Cox predicts that the most investors should hope for is “modest” change.

Directors, meanwhile, indicate that drastic modifications may not be needed.

One audit committee member who has worked in a Big Four audit firm says audit failures or misconduct because of considerations about business are “very rare” in the U.S. Litigation, regulatory scrutiny and reputational risks all serve as deterrents, the director notes.

Still, “public accounting professionals need to work collegially and cooperatively with their clients to be effective and, let’s face it, to be retained. If they don’t, the client will replace them, and it will impact the firm’s and their personal income,” the director says. “There are certainly instances where the desire to please or accommodate a client goes beyond acceptable professional standards, but in my experience, they do not typically involve material issues which compromise the entire audit or audit opinion.”

Audit committee member **Alex Cappello** says he has not experienced problematic relationships between companies and audit firms. Cappello is chairman and CEO at global investment bank **Cappello Global** and serves on the audit committee at **The Cheesecake Factory**.

“I cannot think of a single case where I thought that the auditor was giving special treatment because they were afraid of losing the account,” he says. “In fact, I think it would be my view, at least in my experience, that the auditors have been more concerned with doing the right thing and not getting caught with their pants down around the ankles because they didn’t catch things or they missed impropriety.”

Still another board member says processes exist to keep the audit committee’s relationship with auditors healthy. Those include the requirement to rotate audit partners, a primary contact with the audit committee, the seasoned director with audit committee experience points out. Audit committees additionally meet annually to assess audit firms, which, while the focus may primarily center on auditors’ fees, would include a look at the quality of the work.

Similar to Cappello, the director says that they have not experienced a circumstance in which it appeared there was even a hint that auditors were being told to stand down. Though if the directives were contained within the audit firm, board members might not necessarily know about it, the director notes.

Asked if it would be within the audit committee’s purview to step in if the relationship with an outside audit firm seemed too close, the board member says, “In a heartbeat.”

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