RE: Docket 038

The purpose of audits is to provide investors accurate information about companies they are interested in so they may make rational judgments. The Proposed Auditing Standard on Related Parties and Proposed Amendments on Significant Unusual Transactions are a step in the right direction to make sure that auditing procedures provide accurate information but do not go far enough.

Significant Unusual Transactions:

JP Morgan Chase's admission that it may have lost more than $2 billion on credit default swaps is the most recent example of unusual transactions that should have been reported. According to news accounts these losses occurred because at least part of the bank was betting on the direction its whole portfolio of investments were likely to take. Whether this would have been a technical violation of the Volcker Rule, as Senator Levin has said, or not, as the bank claims, is not as important as the recognition that the bank was putting material sums of money at risk by engaging in naked gambling.

Theoretically the price of bonds reflects the risk of default. Credit default swaps are supposed to be insurance against price movements, but are really naked bets that, but for the exemption in the Gramm-Bliley Act, could be prosecuted as illegal gambling or, at the very least, as buying insurance from an unregistered insurance company. There might be some justification for insuring against a price change in one investment by buying a specific credit default swap, but the only justification for buying credit default swaps for a portfolio is greed. Such an investment may lead to large fees but multiplies the risk.

Have we forgotten how the financial system froze because there were so many credit default swaps that no one knew were good or bad? In fact the problem is still a very real risk to our financial system. According to various analyses there are about $300 trillion of credit default swaps floating around the financial system and no one knows what their net amount is or what our exposure would be if there were another recession in Europe. Although apparently 95% of these credit default swaps are held by our largest six banks, significant losses in any one of them would have an adverse impact on our economy. At the very least, these six banks should be subject to auditing procedures that insure that the amount and kind of credit default risks they have on their books will be reported so investors can more accurately evaluate them.

Related Parties:

Investors need to make sure the directors of corporations represent the interests of shareholders and not of management who nominated them in the first place. The growth in management income has been phenomenal and cannot be justified by any rational economic theory. Since the 1970s, median pay for executives at the nation's largest companies has more than quadrupled, even after adjusting for inflation, whereas pay for a typical non-supervisory worker over the same period has dropped more than 10 percent, according to the Bureau of Labor Statistics. Are American CEOs really worth more than 10 times what British CEOs are paid, as measured by the median income of their employees? A study done by Harvard law professor Lucian Bebchuk *et al.* showed that "the top executive teams of Bear Stearns and Lehman Brothers derived cash flows of about $1.4 billion and $1 billion respectively from cash bonuses and equity sales during 2000-2008." They also found that 10 percent of the profits of the largest 1,000 corporations in the United States went to those companies' top five officers in 2005, but that the CEO's pay correlates negatively with the profitability and market valuation relative to book value. In short, the firms with high CEO pay are not the best performers. What percentage it is now, particularly on Wall Street, is probably beyond mere mortals' comprehension.

Wall Street, or the financial sector, is in a class by itself. From 1960 to 1984 Wall Street's share of U.S. corporate profits averaged 17 percent, but from 1985 to 2008 its share rose to an average of 30 percent. This huge bundle of money attracts some of the best minds in America to Wall Street, where they spend their time designing financial instruments that add little or nothing to economic growth, according to Volcker, but generate huge fees that Wall Street is fighting to protect. This helps explain why in 2010 the share of pretax income going to the wealthiest 0.01 percent reached its highest levels since the IRS began recording incomes in 1913. Of course, some of the CEOs, like Steve Jobs, deserved substantial salaries because of what they have accomplished, but why did the average executive's pay at the nation's largest companies grow from 42 times the average worker's income in 1990 to 325 times it in 2010? And, what is the justification for the enormous sums given to seemingly failed CEOs like Hewlett-Packard's Carly Fiorina?

Auditors should have procedures in place so they can report in detail how the top executives' pay is determined and that it seems it seems reasonable in light of the corporation's performance.

Respectfully submitted,

Martin Lobel
Lobel, Novins & Lamont, LLP
888 17th St. NW #810
Washington, D.C. 20006
Lobel@LNLlaw.com

(By way of full disclosure, I am also Chairman of the Board of Tax Analysts, www.tax.org, but the views expressed are my own.)