April 19, 2012

Ms. Phoebe W. Brown
Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006-2803

Re: Request for Public Comment *on Concept Release on Auditor Independence and Audit Firm Rotation and Notice of Roundtable (PCAOB Release No. 2011-006, August 16, 2011, PCAOB Rulemaking Docket Matter No. 37)*

Dear Ms. Brown:

Our organizations represent all sectors of the global economy, representing businesses that employ tens of millions workers world-wide as well as nonprofit public policy organizations interested in fostering access to capital for entrepreneurs. We appreciate that accurate and transparent financial reporting is a foundation of our global and domestic capital markets. Businesses, as preparers and users of financial reports, must have a strong system of internal controls to raise the capital needed to grow and operate. Strong independent audit committees are an important part of that internal control system which, along with high quality external audits, maintains and enhances the credibility of financial reporting.

We write to express serious concerns regarding the continued consideration of mandatory audit firm rotation. In particular, we are troubled by the failure of the Public Company Accounting Oversight Board ("PCAOB") to demonstrate a factual record for the need for mandatory audit firm rotation or overcome previous rejections of the concept. Furthermore, we believe that mandatory firm rotation, if implemented, will harm overall corporate governance, reduce audit quality, diminish the role of audit committees, increase the incidence of undetected fraud and raise costs.

Our concerns are outlined in more detail in the remainder of this letter.

Audit Rotation has been Rejected and PCAOB Fails to Present Supporting Evidence

Mandatory audit firm rotation is an idea that has been continuously rejected over the course of time. More than three decades ago, mandatory rotation was considered and rejected by the Commission on Auditors' Responsibilities (the "Cohen Commission") as costly and with no net benefit to investors. The Cohen Commission stated that the lack of auditor familiarity with a client in the early years of engagement would cause more harm than benefit for investors.[1] The Cohen Commission concluded that the audit committee is in the best position to evaluate audit effectiveness and decide if appropriate to rotate audit firms. We believe that this conclusion remains true today.

In 1994, the U.S. Securities and Exchange Commission ("SEC") rejected the notion of mandatory firm rotation and stated that there was not a need for rules changes or legislation to further that goal.[2] Following significant financial reporting failures in the Enron and WorldCom incidents, Congress, in debating and passing the Sarbanes-Oxley Act of 2002 ("SOX"), explicitly rejected mandated audit firm rotation instead choosing to mandate audit partner rotation and strengthening the role of audit committees. Additionally, in 2003, the General Accounting Office ("GAO") studied the issue and decided that audit firm rotation was not necessary and would drive up both audit fees and financial reporting costs for companies. More recently Congress again rejected mandatory audit firm rotation through passage and enactment of the Jumpstart Our Businesses Startup Act ("JOBS Act"), which includes a provision banning mandatory audit firm rotation for emerging growth companies.[3]

In proposing the concept release the PCAOB does not provide any evidence from its inspection process that audit firm tenure compromises independence, objectivity, or professional skepticism. Indeed in proposing the concept release and in testimony before Congress, the PCAOB has repeatedly stated that audit quality is

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[1] See *The Commission on Auditors' Responsibilities: Report, Conclusions, and Recommendations* (1978), pp. 108-109. Curiously, in the end, the Concept Release acknowledges that mandatory audit firm rotation will end up lowing audit quality and then asks how to mitigate this effect (pp. 23-24).

[2] SEC Office of the Chief Accountant, Staff Report on Auditor Independence (1994).

[3] The JOBS Act was passed by large bi-partisan majorities in the House of Representatives and the Senate and signed into law by President Barack Obama on April 5, 2012. The intent of the law is to remove regulatory obstacles and encourage the creation of public companies and spur corresponding job growth.

better today than it was 10 years ago. The lack of inspections data supporting the consideration of mandatory firm rotation and the precedent and subsequent statements of improvements to audit quality are telling as the PCAOB has described the inspections process as their window onto the state of audit quality. It appears that the PCAOB is concerned with auditor independence, a laudable goal. However, the current features of independence rules: partner rotation, limits on revenue sources from an audit client, job freeze periods, personal holdings etc, appear to be working based upon the PCAOB's statements on improved audit quality and lack of factual evidence to the contrary.

Therefore, it would appear that the PCAOB has not shown any compelling reason to continue further consideration of mandatory audit firm rotation in the light of the historic record and the lack of a factual documentation demonstrating a need for rotation.

Corporate Governance Concerns

In establishing the PCAOB as regulator for audits of public companies, with oversight by the SEC, SOX gave the PCAOB multiple powers to maintain and improve audit quality through registration, inspection, standard-setting, and enforcement. Also, SOX gives audit committees the responsibility for the appointment, compensation, and oversight of the independent audit firm, along with responsibility for resolving any disagreements between management and the auditor regarding financial reporting.[4] While SOX gives the PCAOB jurisdiction over audit firms, it does not give the PCAOB jurisdiction over corporate governance or authority over the audit committees. Corporate governance remains within the purview of state corporate law or the SEC.

A reading of SOX demonstrates that a fundamental reordering of the audit committee responsibilities and actions would have to emanate from the SEC and not the PCAOB. Mandating a set period for changing audit firms—which would preclude both longer and shorter periods (at least without regulatory consent of some form)—deprives audit committees of discretion and judgment, contravenes SOX and

[4] In addition, many public companies now require shareholder voting to ratify the retention of the audit firm recommended by the audit committee.

audit committee responsibilities for audit firm selection and supervision. On the surface, audit firm rotation constrains and unduly complicates the work of audit committees. It appears, therefore, that the PCAOB is overstepping its authority.

Academic Studies

From the standpoint of evidence on the implications of auditor tenure, it is also important to recognize that the weight of the evidence from academic research does ***not*** support the implementation of mandatory audit firm rotation. Indeed, a recent review of the research literature finds that the evidence suggests several attributes of audit quality improve as auditor tenure increases.[5] Further, research on fraud by a member of both the PCAOB's Standing Advisory Group ("SAG") and Investor Advisory Group ("IAG") finds that fraudulent financial reporting is more likely to occur in the first three years of the audit-client relationship and fails to find any evidence that fraudulent financial reporting is more likely given long auditor tenure. Similar to other studies, this study concludes that the results are consistent with the argument that mandatory audit firm rotation could have adverse effects on audit quality.[6]

Mandatory Audit Firm Rotation Would Be Costly and Disruptive to the Markets

Cost-benefit analysis is one effective approach to improving audit quality. In light of the weight of the academic research debunking mandatory audit firm rotation, it would seem that there is no net benefit for investors in moving forward in the

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[5] For a review of academic research on mandatory audit firm rotation see "The Causes and Consequences of Auditor Switching: A Review of the Literature" by C. Stefaniak, J. Robertson, and R. Houston in *Journal of Accounting Literature* (Gainesville: 2009) Vol. 28: 47-122. The study acknowledges some evidence indicates that mandatory auditor rotation might improve audit quality in certain situations, although not without costs. Thus, even this evidence does not suggest convincingly that the benefits of mandatory auditor rotation will exceed its overall costs.

[6] For example, see "Audit Firm Tenure and Fraudulent Financial Reporting" by J. Carcello and A. Nagy in *Auditing: A Journal of Practice & Theory* (Sarasota: September 2004) Vol. 23 (2): 55- 70. Also, see two monographs in 1999 and 2010 from the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") using SEC Accounting and Auditing Enforcement Actions during 1987-1999 and 1998-2007 as a proxy for fraudulent financial reporting. The latter, *Fraudulent Financial Reporting 1999-2007* by M. Beasley, J. Carcello, D. Hermanson, and T. Neal, reported that 26% of fraud companies switched auditors between the issuance of the last clean financial statements and the last set of fraudulently misstated financial statements, as compared to 12% of no-fraud firms during the same time period (p. 37).

consideration of the Concept Release, perhaps one of the reasons that a majority of investors have commented negatively against the concept of mandatory audit firm rotation.

As discussed earlier, mandatory audit firm rotation would be extremely costly and disruptive to the U.S. capital markets, harmful to investors and have far reaching negative consequences. The Concept Release acknowledges that mandatory audit firm rotation would disrupt markets and increase audit costs.[7] Likewise, the costs and disruptions arise from many sources and are largely unexplored in the Concept Release. Disruptions would extend to capital formation activities including initial public offerings and mergers and acquisitions. It should be noted that the JOBS Act specifically bans mandatory audit firm rotation for emerging growth companies. Mandatory audit firm rotation makes auditor choice and change a much more complicated proposition for companies and audit firms with interdependencies beyond the control of any particular party. The concept release fails to take into account the massive regulatory changes, mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), upon the capital formation activities of companies. It is possible that overlaying mandatory audit firm rotation on top of all the many existing restrictions on audit choice would leave some large global companies without any available, eligible, requisite audit firm.

That would be harmful for investors, companies, and capital formation with direct negative consequences for economic growth and job creation.

The GAO Study estimated that initial year audit costs under mandatory audit firm rotation would increase by more than 20 percent over subsequent year costs, in order for the auditor to acquire the necessary knowledge of the public company. In addition, the GAO Study estimated that under mandatory audit firm rotation, companies would incur auditor selection costs and additional auditor support costs totaling at least 17 percent or higher as a percentage of initial year audit fees. [8]Moreover, these estimates were made before integrated audits of both the financial statements and internal control over financial reporting. It is likely that those costs would be higher today, in light of the additional reporting requirements imposed by

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[7] Concept Release (pp. 3).
[8]See U.S. General Accounting Office, Required Study on the Potential Effects of Mandatory Audit Firm Rotation (2003).

post SOX legislation and regulations including the Dodd-Frank Act. Also, as stated earlier, research shows that there is an increase in costs and fraud potential during the first three years of a new auditor engagement.

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Thank you for the opportunity to comment on the proposed Concept Release on mandatory audit firm rotation. We believe that this is an idea whose time has not come and would be harmful to companies and the investors who invest in them. We encourage the PCAOB to drop this issue and focus its attention upon salient issues within its jurisdiction related to maintaining and improving audit quality, including a review and update of PCAOB auditing standards, the bulk of which have been in existence well before the passage of SOX and the creation of the PCAOB itself.

Sincerely,

American Council of Life Insurers
American Insurance Association
Building Owners and Managers Association (BOMA) International
Competitive Enterprise Institute
Council of Federal Home Loan Banks
CRE Finance Council
Dover Corporation
FedEx Corporation
Food Marketing Institute
International Council of Shopping Centers
Investment Company Institute
Mortgage Bankers Association
NAIOP, Commercial Real Estate Development Association
National Association of Home Builders
National Association of Real Estate Investment Trusts
National Parking Association
Property Casualty Insurers Association of America (PCI)
Rayonier
Retail Industry Leaders Association (RILA)
Reynolds American Inc.

RPM International Inc.
Safeway
Smithfield
The Clearing House
The Council of FHL Banks
The Financial Services Roundtable
The Real Estate Roundtable
U.S. Chamber of Commerce
United Healthcare
Viacom Inc.