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Office of the Secretary
PCAOB
1666 K Street, N.W.
Washington, D.C. 20006-2803

Re: PCAOB Rulemaking Docket Matter No. 37

Dear Sir or Madam:

I wish to provide you with my thoughts regarding mandatory auditor rotation. The PCAOB Release No. 2011-006(the "Release)" was useful in providing information and insight into the Board's thinking regarding this matter. I offer my thoughts and comments with the benefit of years of experience, both in public accounting firms and in industry. My public accounting experience includes that of a new staff member through partner, with responsibilities for public companies. My industry experience is largely with multinational publicly traded companies as Chief Financial Officer and Corporate Controller.

You noted in the Release's first paragraph that "An audit has value to financial statement users because it is performed by a competent third party who is viewed as having no interest in the financial success of the company." While I agree that auditors are generally competent third parties, I disagree with auditors having no interest on the financial success of their clients. I base this on the following:

- Without a company being a financial success, it may not be in a position to pay the auditor its fees for services rendered.
- Clients are assessed by auditors regularly for financial stability. If an assessment is made that a client may not be successful, then a decision is made to either terminate the relationship or increase the level of fees to compensate the auditor for the increased level of risk associated with retaining the company as a client. Accordingly, pricing and profitability per client is continuously evaluated, resulting in an expectation that clients are sufficiently successful to pay the current professional fees and to avoid future litigation costs should there be a future going concern or other issue.
- The "mindset" of an auditor has, in my view, always been to be pro-active with respect to looking for opportunities to suggest improvements to their clients, both control and operational. This mindset may be a contributing factor as to why auditors may have difficulty with respect to healthy skepticism.

Based on the specific needs and requirements of each company's audit requirements, the time needed to complete the task will differ. This translates to different levels of fees for different companies, notwithstanding market capitalization, revenues, net assets, profitability or other metrics. Fees are a negotiated matter between two parties, somewhat independent of what other companies are charged by their auditors. Since the fees are negotiated between the auditor and the client, and since the client pays the auditor directly for audit services rendered, it is not possible for the auditor to avoid having an interest in their clients' continuing success. Moreover, the structure for negotiating and paying of fees will not provide for a separation of this conflict, short of the level of fees being set and paid by an outside third party, a solution that I do not think is practical or feasible.

Notwithstanding the above, I believe that it is possible for an auditor to maintain a sufficient level of independence, objectivity and professional skepticism with the fee negotiation and payment process continuing as currently exists. It should be noted that the greater the client base, the less likely it is that an individual auditor will be influenced by fees from any one client.

I note the Board continued to find instances in which it appears that auditors did not approach some aspect of the audit with the required independence, objectivity and professional skepticism. However, I do not agree that a mandatory auditor rotation would be a practical solution to this matter.

Professional skepticism is a mind-set that is developed with education and experience. Reflecting on my education and experience, I do not believe that enough emphasis was placed on this trait – in undergraduate and graduate school or in public practice. It is certainly an issue in industry as companies attempt to balance accounting and disclosures matters that "factually and judgmentally" exist – on the one hand the pressures of conservative reporting, and on the other hand meeting or exceeding market expectations.

Additionally, since professional skepticism is, by definition, a position that may be viewed as one of conflict, this is problematic and stressful for most individuals. Some individuals are able to find a balanced view of healthy skepticism, while others are not. Moreover, often healthy skepticism is misinterpreted as cynicism. Identifying the issue is different than solving the issue. I would argue that the matter of an appropriate level of healthy skepticism is (or should be) a concern of all firms. Simply changing auditors will not "fix" this problem, since personnel at both a predecessor and successor firm have individuals that struggle with this required trait. Accordingly, the fundamental problem will not be resolved.

Enabling auditors to maintain a balanced view in applying healthy skepticism is a challenge. At this point, I am not certain that colleges/universities are planning on curriculums to address this matter. Auditors are becoming extremely risk adverse to avoid lawsuits which puts pressure to be overly conservative, except when attempting to engage additional clients, in which case the opposite view is a risk. This situation places auditors in a position that providing balance in training may not occur. A potential solution is for auditors to be trained from an independent group (e.g., the AICPA) periodically on the meaning and application of healthy skepticism. A case-based course may work very well to achieve that goal.

An additional issue for your consideration regarding mandatory auditor rotation: one of perceived audit failure of the predecessor auditors by the successor auditors. While serving in industry, I participated in auditor changes at four companies. In each instance, the successor auditor identified disagreements in accounting and/or reporting matters that became challenging to resolve between them. Being caught between the two accounting firms (with neither side swayed by management's judgments and conclusions), we were forced on two occasions to file financial statements late with the SEC. There seems to have been a sense of "the old firm did it wrong" by the incoming firm, resulting in more time and expense incurred by the companies at which I was employed, as well as the negative impact from the public for late filings.

Mandatory auditor rotation will also result in increased costs (due to first time through work) and inefficiencies (resulting from the new auditors sufficiently understanding the new client's business model and/or its processing procedures/internal control structure). Having participated in changes in audit firms on both sides of the fence, I have observed that this is a significant matter to auditees. The level of effort to get a new audit firm up to speed is substantial. Additionally, my recollection that costs associated with first time through work ranged typically from 20 - 25% of the audit fees for the first year. I complete agree with the Board's recognition that a rotation requirement would risk significant cost and disruption.

Disruptions in continuing clients also will have a negative impact on audit firms. Changing personnel requirements, marketing efforts and other attendant issues will put more pressure on accounting firms to retain profitability and growth. This will also result in additional cost increases for auditees and increase the risk of audit firm financial failures.

The audit procedures performed and resulting opinion on a company's financial statements are subject to a significant level of judgment. Judgments regarding the appropriateness of recorded amounts and balances and the adequacy of disclosures are the responsibility of management. Another issue considering health skepticism is the fact that the auditors may not have the same view regarding these matters for a variety of reasons. Knowledge of a company and of an industry certainly come into play, and changes in auditors increase the risk of an appropriate level of healthy skepticism being applied by a new audit firm.

I disagree with the Cohen Commission's position that "since the tenure of the independent audit would be limited, the auditor's incentive for resisting pressure from management would be limited." In fact, I would argue the opposite – knowing each client has a certain shelf life and that there are costs associated with obtaining new clients, it may be argued that auditors would be incented to keep existing clients for as long as the rotation period allows, increasing the pressure from management.

Anecdotally, I understand that a publicly traded company in Italy was required to change auditors. As part of the change, the audit team members serving the client from the predecessor auditor resigned and were employed by the successor auditor, all working on its "new" audit client. Nothing was gained by this change. This issue would also have to be addressed.

At the end of the day, almost everyone has conflicts of interests – from news organizations and their sponsors, drug manufacturers and their customers, stock brokers and their clients, etc. It therefore becomes a key to recognize that conflicts are inherent and the infrastructure as developed by involved parties (auditors, PCAOB, AICPA, etc.) is sufficiently developed to manage that risk.

Thank you for allowing me the opportunity to provide my comments on this matter.

Very truly yours,

James F. Anderson