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Office of the Secretary  
**Public Company Accounting Oversight Board**  
1666 K Street, N.W.  
Washington D.C.  
USA 20006-2803

VIA E-MAIL

Re: *Auditor Independence and Audit Firm Rotation*  
*y/f: PCAOB Rulemaking Docket Matter No. 37*  
*of: 20110307.4*

Dear Sirs, Mesdames,

We thank the *Public Company Accounting Oversight Board* ("PCAOB") for this opportunity to provide comments on the *2011 PCAOB Concept Release on Auditor Independence and Audit Firm Rotation*.

*CGI Group Inc.* is a large multinational public company whose shares are listed for trading on the Toronto (GIB.A) and New York (GIB) stock exchanges and are included in both the *Dow Jones Sustainability Index* and the *FTSE4Good Index*. CGI's website is [www.cgi.com](http://www.cgi.com).

Founded in 1976, CGI is one of the largest independent information technology ("IT") and business process services firms in the world. CGI and its affiliated companies employ approximately 31,000 professionals. CGI provides end-to-end IT and business process services to clients worldwide from offices and centers of excellence in the United States, Canada, Europe and Asia Pacific. As at CGI's year end on September 30, 2011, CGI's annual revenue was approximately \$4.3 billion and its order backlog was approximately \$13.5 billion.

We preface these comments with the following disclaimer: we are the subject of the audit process, and not an audit firm, and for that reason there are a number of questions posed in the PCAOB concept release that we are not well-placed to answer or comment upon.

We support the principle of auditor independence and many of the measures resulting from the adoption of the *Sarbanes Oxley Act of 2002* ("SOX") that promote auditor



independence as means to ensure the overall reliability of public companies' financial reporting.

We doubt however whether adopting a general requirement of audit firm rotation will contribute in any significant way to an overall enhancement of auditor independence, or to improving the ultimate reliability of financial reporting.

There is a general lack of quantitative support for the proposition that audit firm rotation will yield the hoped for benefits related to auditor independence. This is a proposal that has existed, as noted in the concept release, for a very long time, and that has yet to be adopted.

The reason is that a cost/benefit analysis shows quite convincingly that the disadvantages that may reasonably be expected heavily outweigh the potential benefits of such a policy.

#### ***Perceived benefits of audit firm rotation***

- Limiting the term of audit engagements reduces the auditor's susceptibility to management's pressure to accept otherwise unacceptable accounting practices and policies because the audit firm does not have a long term business relationship to protect.
- Incumbent auditors might be inclined to scrub their audits more vigorously at the end of engagements leading to a higher quality of audit.
  - We note that this potential benefit may be in doubt since it would be strongly mitigated by the incumbent's reluctance to correct past results that may have been relied upon by investors. Corrections that might result in material restatements, which are precisely the ones that might be hoped for, would be those that would be most resisted by the incumbent because of the very real risk of civil liability.
- Bringing in a new audit firm when the incumbent auditor's engagement ends brings a fresh perspective to the audit.

#### ***Anticipated costs and risks related to audit firm rotation***

- The cost of changing audit firms is far from insignificant. Those costs go right to an issuer's bottom line and ultimately the shareholders recognize that cost as a lower earnings per share ratio and a lower stock price. The US *General Accounting Office* survey alluded to in the concept release discloses an estimated 20% increase in audit costs for the first year of the new audit firm's engagement. There are also costs incurred in the terminal year of the incumbent audit firm's engagement as the new auditor is required to perform a shadow audit to support the transition. At CGI we changed our auditor in 2010. In addition to the direct costs of overlapping audit fees in the transition year, there are also costs after the fact as both the new audit firm and the predecessor firm are required to provide consents for securities filings where the filings rely in part on the prior year statements audited by the predecessor firm. The overall costs for the issuer of audit firm rotation are therefore substantial and cast their shadow over multiple years of both auditors' engagements.



- Added to the cost equation for multinational firms is the audit requirement frequently imposed on wholly-owned subsidiaries that operate abroad. For instance, most jurisdictions in Europe and Asia as well as Australia impose an audit requirement for wholly-owned subsidiaries. A company like CGI therefore faces audit firm rotation not only at the parent company level for the consolidated financial statements, but also at the subsidiary level for non-consolidated subsidiary financial statements. This further magnifies the external and internal costs associated with a change of audit firm.
- Increased audit risk posed in the earlier years of an audit engagement by the new audit firm attributed to the new audit firm's lack of experience with the issuer's affairs.
- Management of the issuer being required to devote substantial effort, time and attention to the transition process as well, diverting resources from the financial reporting process which may itself increase the risk of misstatements.
- Potentially higher vulnerability to fraud due to the incumbent auditor's unfamiliarity with the issuer and its operations and processes resulting in less reliable detection of fraud perpetrated by management.
- The worldwide consolidation among audit firms leaving large multinational firms like CGI to choose among the top four audit firms. When the field is further winnowed by discarding audit firm candidates that find themselves in a conflict of interest, a firm like ours is likely left to choose among two firms. Rotating the audit firm among two firms seems to obviate many of the hoped-for benefits of audit firm rotation. To the extent that many large multinational firms find themselves in a similar position, the overall benefits for audit assurance for large public companies will be minor at best.
- Auditor independence reforms introduced with SOX further complicate the value proposition for audit firm rotation. The restrictions on non-audit services imposed under SOX means that issuers must turn to other big four firms to perform those services. If one accepts that the prohibited services are inherent threats to the auditor's independence, the firms currently providing those services to the issuer would not satisfy the auditor independence criteria and would therefore automatically be excluded for consideration when the time came for rotation. In addition, the requirement to ensure that there are no independence issues raised by relationships between the directors of the issuer and audit firm candidates, further narrows the range of choice.
- Incidences of audit firm rotation since the adoption of SOX were in large measure driven by other issues, not the least of which were the disappearance of Arthur Andersen, and the desire on the part of many issuers to reduce the substantial impact of SOX related costs by shopping for reduced audit fees (Forbes, August 2011 – *Auditor Rotation Proposal Just More Spin*). The pressure on the new auditor to win the engagement by offering lower audit fees may result in the new auditor sacrificing the quality of the audit to maintain its profit margin.

#### ***Other considerations***

The PCAOB acknowledges that its perception of the risks posed by lack of auditor independence suffers heavily from a selection bias in the sense that the anecdotal evidence on which the concept release relies stems from the PCAOB's own enforcement activities. The



incidence of audit failures noted by the PCAOB is of 200 problems found in a sample of 2,800 reviews. The PCAOB also acknowledges that not all the 200 instances of “audit failure” resulted in a misstatement of an issuer’s financial statements.

In addition, the PCAOB also acknowledges that of the cases where audit failure was found, it was only in a fraction of the cases that an issue could be traced to “the failure to apply an appropriate level of professional skepticism”. Of those cases, there is no empirical evidence cited by the PCAOB to tie insufficient skepticism to long term audit engagements.

Based on the limited data provided, and even assuming that fully half of the audit failures were squarely attributable to a lack of professional skepticism, and that fully half of those cases were squarely attributable to the long-term nature of audit engagements, the incidence of long term audit engagements as a risk at the source of an audit failure is well below the two percent threshold. If fully half of those cases resulted in a material misstatement, it seems that the scope of the problem, even assuming those generous estimates, is very small indeed.

The true correlation is most likely much, much less evident. In fact the concept release states that the preliminary analysis of the PCAOB’s own inspection data appears to show no correlation between auditor tenure and number of comments in inspection reports.

Given the substantial cost/benefit imbalance, we believe that imposing an arbitrary audit firm rotation requirement to address a perceived risk of such a small magnitude, would be a grave error on the part of the PCAOB and would potentially result in the unintended consequence of an erosion in the quality of audited financial information, and a resulting erosion of public and investor confidence in audited financial statements.

#### ***Policy alternatives to address audit-related risks***

##### ***Allowing audit committees to play their role***

Governance measures that have enhanced the independence and expertise of audit committees and clearly delineated the role of the committee in selecting the auditor and monitoring the auditor’s independence are important initiatives that ought to be relied upon as one of the key measures in ensuring the independence of the external auditor.

The regular *in camera* (or so-called ‘executive’) sessions that the audit committee holds separately with management and the external auditor allow the committee to test its perception of the relationship between the auditor and management on a regular basis and to gauge whether the external auditor has become complacent, is failing to show sufficient professional skepticism in reviewing management’s accounting practices and estimates, or otherwise is failing to perform the duties expected of an auditor.

The members of the audit committee are exposed to sanctions, including the threat of civil liability, in the event that there is a significant failure in financial reporting. The external auditor plays a key role not only in providing reasonable assurance to shareholders and other stakeholders, but also to the directors who sit on the committee, that the issuer’s financial statements reflect accurately its financial position and the results of operations.



Imposing an arbitrary term limit on audit engagements interferes with and usurps the audit committee's discretion with respect to the selection and replacement of the auditor, and to the extent, as noted earlier in our remarks, that, on balance, it exacerbates the risk of misstatement, it unfairly places undue incremental risk on the Board of Directors as a whole, and on the members of the audit committee in particular,

#### ***Audit firm consolidation and concentration***

The concept release discusses the history of this issue and notes in that context that in 1977 large multinational firms like CGI had the top eight audit firms to choose from. In 2011, the field is down to the top four firms. One of the key audit-related concerns alluded to in the European Commission's 2011 Green Paper *Audit Policy: Lessons from the crisis* is the systemic risk posed by the resulting audit firm oligopoly. In particular, the paper poses the question that haunts governments and regulators in the global economy today whether the top four accounting firms are already too big to fail.

This begs two questions: i) whether the oligopoly renders audit firm rotation completely unrealistic as a regulatory policy option for large multinational public companies, and ii) whether accounting firm regulators like the PCAOB ought to be devoting their policy resources to the systemic and regulatory risks increasingly posed by the oligopoly.

#### ***The benefits of vigorous and consistent enforcement***

The concept release notes that the SOX requirements together with the enforcement activities of the PCAOB have to date yielded substantial improvements in the quality of audit assurance for public company financial reporting.

To the extent that the PCAOB has a legitimate concern that audit firm staff may not be displaying sufficient professional skepticism in the context of their audit work, this is an enforcement issue that the PCAOB should focus particular attention on. This concern relates to professional conduct on the part of the accounting profession and should be addressed first and foremost in a direct fashion by educating the profession and imposing meaningful sanctions when auditors' performance falls below the expected professional standard.

The regulator should resist the temptation to deal with that concern obliquely and indirectly by adopting an audit firm rotation requirement. This would be yet another example of disciplining the accounting profession by awarding a windfall of fees for audit firms similar to the egregiously lucrative outcome of SOX section 404. In Canada issuers suffered to a lesser extent because Canadian regulators decided not to require an audit opinion on the effectiveness of internal controls over financial reporting.

We concede that auditor term limits and audit firm rotation may yet have a useful role to play in the regulatory context.

We suggest however that the requirement, to the extent that it is imposed, be reserved as a sanction to be applied in specific cases where a PCAOB inspection reveals, on the basis of clear evidence, that the independence of the incumbent auditor has been compromised as a result of an inappropriate relationship with the issuer's management in a way that justifies the remedy. Limiting the requirement in that way might make sense.



Limiting the requirement to only the largest issuers in the way suggested in the concept release as a way of mitigating the negative impacts of audit firm rotation, seems a very wrong approach, because, as noted earlier, the oligopoly considerations that mitigate strongly against the policy apply most starkly to the audit of the largest issuers.

In the meantime, to the extent that the PCAOB concludes that the topic of audit firm rotation deserves further study, the PCAOB should consider surveying issuers that, like CGI, have undergone a change of auditors in the recent past so that a body of fresh and reliable data might be gathered to support further policy deliberations.

Once again we thank the PCAOB for this opportunity to comment on the concept release and we invite you to contact the undersigned in relation to these comments, should the need arise.

Yours truly,

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