December 1, 2011

Mr. Martin F. Baumann
Chief Auditor and Director of Professional Standards
Public Company Accounting Oversight Board (PCAOB)
1666 K Street, NW
Washington, DC 20006
baumannm@pcaobus.org

RE: PCAOB Release No. 2011-006, PCAOB Rulemaking Docket No. 37

Dear Mr. Baumann:

The Mortgage Bankers Association[1] appreciates the opportunity to reply to the *Concept Release on Auditor Independence and Audit Firm Rotation* (Concept Release). Many of our members are publicly held companies or emerging businesses that may become publicly held in the future. They have expressed concerns about the costs and possible ramifications of the proposed rotation of external auditors.

Background Information

On August 16, 2011, the PCAOB issued a concept release to solicit public comment on ways that auditor independence, objectivity and professional skepticism could be enhanced. The PCAOB is considering whether other approaches could foster a more fundamental shift in the way the auditor views its relationship with its audit client. One such approach would be for the SEC to require mandatory rotation of auditors for publicly held companies.

MBA's Concerns

MBA Disagrees with the General Context of the Concept Release

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

The recommendations in the Concept Release appear to suggest a foregone conclusion that audit firms and their clients will not do the right thing with regard to conducting high quality audits. The MBA disagrees and believes that most audit firms and their respective partners value their professional reputations. They know that poor audit quality would lead to loss of clients, and neither the audit firms nor their clients want sanctions, re-statements, or lawsuits. MBA believes the incidence of audit failure is low, and the existing system of controls is sufficient to provide the necessary checks and balances to identify potential audit failures. MBA recommends that unless there is overwhelming, compelling evidence that auditor rotation will greatly enhance the ability to identify and address audit failures, and auditor rotation is cost-beneficial, the PCAOB should not implement mandatory auditor rotation. PCAOB should instead focus on effective implementation of the existing system of controls and provide appropriate consequences and transparent communications when there are true audit failures as opposed to reasonable differences of professional opinion.

Only a Handful of Firms to Perform Multi-national Audits

MBA notes that consolidation in the audit industry has led to only a handful of auditing firms who can handle complex, multi-national audit engagements. Furthermore, many audit firms specialize in a certain industry further limiting the number of firms qualified to handle a particular engagement. The limited choices may make mandatory rotation of auditors impractical. Along the same line, firms that were used as a consultant can't re-cycle to subsequently be the auditor of the client for a period of years, making the field of firms available to the client for auditor rotation even narrower. Most importantly, if audit rotation was mandatory, requiring an entity to engage an audit firm that lacks the knowledge and experience to handle an audit would increase the risk of audit failure. MBA is especially concerned because mortgage banking has some very complex accounting principles related to sale, securitization, consolidation, hedge accounting, and the classification and measurement of financial instruments.

The PCAOB, Accounting Firms, and the SEC have already established controls to ensure auditor independence

MBA notes the following controls are already in place to ensure auditor independence and the integrity of the audit process. First, engagement partners are required to rotate off of engagements on a regular basis. Second, firms require that an independent partner review the financial statement draft and the workpapers associated with key accounting and auditing issues. Third, most firms have periodic inter-office reviews of audits. Fourth, firms engage another auditing firm to review the controls of the firm and a sample of engagement workpapers. Fifth, auditors on SEC engagements must report directly to the audit committee of the client, and the audit committee must have at least one director with financial accounting and reporting knowledge and expertise. Sixth, accounting firms have already spun off consulting practices which otherwise could have given rise to conflicts of interest or independence issues. Seventh, public companies spend millions of dollars annually to perform internal reviews of their financial accounting and reporting controls under Section 404 of the Sarbanes-Oxley Act (Section 404), and the external auditor reviews the Section 404 workpapers to test the veracity of management's attestation that the controls systems are adequate and functioning. Finally, the PCAOB independently reviews audit workpapers for a sample of publicly held companies each year.

MBA believes that the layers of controls and independent reviews, as described above, should adequately address concerns about possible audit failure and auditor independence. That is, we do not believe additional requirements, such as mandatory auditor rotation, would provide additional assurance. Rather, we recommend that the PCAOB focus on monitoring and reviewing audit firms based on the controls and procedures already in place.

Below, we elaborate with regard to our concerns regarding mandatory audit rotation.

<u>Lack of Knowledge and Experience in Some Firms Could Result is More Costly and Less Effective Audits</u>

Certain firms have developed industry knowledge and expertise that would be difficult to maintain in an environment where audit firms are regularly rotated. Rotation could lead to more frequent audit failures in the future. As Former SEC Chairman, Harvey Pitt, stated on page 13 of the Concept Release "… the unique strengths particular audit firms bring to the clients in certain industries." "… large accounting firms are not fungible … and there can be valid market-driven reasons, such as expertise in a certain industry, for selecting and retaining one firm over others." Page 17 of the Concept Release also acknowledges, "… the learning curve is too steep for an auditor to perform a high-quality audit in the early stages of a new client engagement."   Page 16 notes, "… empirical studies show that fraud is more likely in the early years of an auditor-client relationship."

MBA notes that many audit engagements of publicly held companies are extremely complex, and the learning curve for a successor firm would be steep. In the transition, institutional knowledge held by the predecessor auditor would be lost adding to the risks and costs of the first few years' audits after auditor succession.

MBA is concerned that required rotation of auditors could lead to less effective audits and may result in more audit failures in the first few years of tenure of a successor auditor. Furthermore, we believe audit firms would increase fees to allow for the additional time required for the learning curve. As a result, entities will pay more for a possibly less effective audit. Also, the costs of mandatory auditor rotation coupled with other costs, such as Section 404, could discourage emerging businesses from going public.

<u>Other Concerns</u>

MBA notes that many publicly held companies are headquartered away from large metropolitan areas where large accounting firms maintain offices. The large or regional firm headquartered in a small town is likely a firm that specializes in auditing companies in the industry of the town's largest company. Upon rotation, that office would lose a significant client and might be forced to close, forcing families to move to where jobs are located. A successor firm would likely staff the engagement remotely, forcing auditors to travel a majority of the time. Thus, mandatory auditor rotation could result in more dislocation of audit firms and auditors. During the long term, public accounting could become a less attractive industry resulting in a reduced ability to attract the most talented candidates. In addition, during the past twenty years, several regional firms have emerged as specialists in particular industries such as auditing financial services firms. Mandatory auditor rotation could drive these firms out of auditing publicly held companies further concentrating the audit industry.

MBA believes that for the industry to experience such potential upheavals, the PCAOB should have strong empirical evidence that the auditor firm rotation will, in fact, work effectively and be cost beneficial.

Furthermore, as the SEC and the PCAOB continue to layer on rules regulations, and processes on American businesses, they should be concerned that the burden of those rules will result in companies raising capital and moving operations and commerce off-shore.

MBA Recommendation

MBA believes that the risks of the PCAOB's proposal far outweigh the potential benefits. MBA recommends that when the PCAOB finds evidence in an audit engagement where the audit team did not demonstrate appropriate healthy skepticism, it should look further to see what process or processes broke down. For example, did the independent partner review, the inter-office review, the peer review mechanisms fail to detect the condition? Should the subject firm expand those procedures?

MBA also recommends that the overall peer review results be reported publicly, and individual engagement findings be reported directly to the audit committees of the respective companies. This would provide audit committees meaningful information as part of their ongoing assessment of audit performance and assist them in determining if audit partner or audit firm change is appropriate.

MBA appreciates the opportunity to share its observations with you. Any questions about MBA's comments should be directed to Jim Gross, Vice President, Financial Accounting and Public Policy and Staff Representative to MBA's Financial Management Committee, at (202) 557-2860 or jgross@mortgagebankers.org.

Yours truly,

David Stevens
President and Chief Executive Officer
Mortgage Bankers Association