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**To:** [Comments](#)  
**Subject:** PCAOB Rulemaking Docket Matter No. 37, Auditor Independence and Audit Firm Rotation  
**Date:** Friday, December 02, 2011 8:52:39 PM

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## PCAOB Comment Letter

I appreciate the efforts of the PCAOB to enhance audit quality and to broaden understanding by the investing public. The PCAOB goal to protect investors is an element of the fiduciary objective of a Company's Board of Directors and its Audit Committee, at least in the US. Outside the US, Boards and Committees operate differently by both general practice and law/regulation, and academics seem to have undue influence on regulators.

The Concept Release points out many on-point negatives to mandated auditor rotation. I agree with all of them. They should be sufficient to quash the rotation mandate being proposed by the PCAOB. I would add that the requirement would be equally disruptive and costly in time and distraction to management, Company staff and the Board. The focus on business operations and shareholder return would be diluted by the auditor rotation exercise and its effects, exposing whether shareholder interests were best protected. Delaware law states that the Board's primary responsibility is to act in the best interests of the Company and its shareholders. Taking the operating responsibility of auditor selection out of the hands of the Board may create legal issues and confuse shareholder expectations.

Yet I recognize that some have a poor *perception* about whether auditors are really independent; some have real *concern* about their independence; and some seek more transparency about relationships and history with the external auditors. As a result, I offer some other approaches, singly or in combination, that may appropriately be considered to better address those needs.

I believe that relating the complex background of well publicized large company failures and the PCAOB's experience in categorizing "audit failures" in audit firms' examinations to an independence problem with independent auditors that might be cured by audit firm rotation is a leap well beyond any supportable facts, certainly insufficient to warrant a costly and problematic conclusion such as the proposed mandated auditor rotation. The reasons put forth to justify such a requirement are insufficient to make the changes proposed/considered.

The "SOX" legislation of 2002 placed significant and new responsibility on the Audit Committees of Boards of Directors of public companies. It greatly changed the dynamic of the auditor relationship as well as, in many cases, that between the Board and management. The Audit Committee ("AC") became the contracting party in engaging independent auditors to review financial statements and/or performing other services to

the registrant. The role changed from advisory to management to primary. Taking decisions such as the selection of auditors away from the group best or better informed about company needs, complexities, controls, internal capabilities, historical relationship with the CPA firm, capabilities of the firm, confidence, trust, etc, appears misguided. And it expresses no confidence in the job that most if not all Audit Committees have performed in a significantly different and better way over the past several years.

The PCAOB's release noted that Cohen Commission in 1978 "recommended against mandatory auditor rotation and concluded that the audit committee is in the best position to determine whether rotation is appropriate." The SEC supported that conclusion again in 1994. SOX moved that positioning further forward several strides. It's changes were powerful. . I believe such changes have been particularly profound when CPAs have been members of ACs. When SOX was developed, former Chairman of the SEC Harvey Pitt agreed with the Cohen Commission conclusion. Post SOX, the AC owns the relationship with the audit firm. Directors are elected directly by shareholders for a reason.

Shareholders can express their views via that process. Director roles and responsibilities to shareholders are defined by practice and by law. Increasing the credibility and understanding of the audit in the public mind, if and as needed, is not an independence issue. Rather, the "expectation gap" is an investor education and auditor scope issue. If auditors are deemed to need to expand procedures, re-define GAAS. Independence cures might focus greater attention to the directors not the auditors.

I personally do not believe the PCAOB has received enough input from AC members or chairs. As an active AC Chair, I attend numerous seminars for CPE, read all manner of Board publications, read or participate in business press, NACD, law and accounting firm updates, webinars, conferences, surveys, etc. The changes since SOX seem compelling, yet appear not to be adequately recognized by the PCAOB. My opinions have not been sought in a fashion that is practical. And certainly most AC voices are quieter than outspoken critics who enjoy getting press or narrow constituencies that have another agenda. AC members are working to fulfill their responsibilities, not writing letters or getting interviewed. I encourage the PCAOB to get AC input regarding post-SOX changes, and their effects on control over the audit process and auditor independence

In any case, I have several suggestions and further observations on the points/questions you raise. I also start with a premise that most professional individuals working for a CPA firm or responsible for preparing financial statements for registrants operate with a certain professional ethic and moral compass. Auditors and registrants generally have the same focus in collaboratively seeking fair presentation of results and disclosures. There have certainly been unfortunate exceptions to that premise, but the lowest common denominator should not necessarily drive regulation. While the professional skepticism required of an auditor is important to the audit process, only a minority of the investing public starts being skeptical about auditor independence or the quality of financial

reporting. Most have faith, based on far greater positive experiences than negatives. So the objective should be how to best and efficiently control the outliers-the failures, the frauds, the scope misconceptions-and not take reasoned judgment out of the process. Another premise of mine, based on real-life experiences not necessarily known to those skeptics or rotation advocates, is that major accounting firms believe very strongly that no client is too big to walk away from, that accumulated profits from the most desirable or largest accounts is not equal to the cost of an audit failure and related litigation or damaged reputation.

1. The focus should be first and foremost on the AC. Some expansion of the financial capability and acumen requirements to be a member or Chair of an AC, or for the majority of AC members, may be helpful and warranted, to ensure greater ability to oversee and hold accountable the external auditors, internal auditors, and financial management. Overseeing the financial functions as a COO or CEO may not be sufficient to understand the nuances of accounting, financial reporting and disclosures nor the operations of internal auditors or the profession of public accounting and auditing. The requirements as they currently exist may be too broad to accomplish an intended or improved result. While many non-CPA AC members or Chairs without direct CFO or CAO experiences do an excellent and thorough job in their roles, some of the public company frauds and failures have had ACs without, in hindsight, requisite skill sets. While not seeking the near-term replacement of existing AC members or Chairs, when qualifications or performance might be in question their successors or fellow members perhaps should have to meet more stringent financial capability requirements. The proxy statement from the AC might be expanded to document the financial capabilities of the AC and perhaps justify its composition. Some rotation of members within or among the AC and the Board might also be mandated or encouraged as "best practice".

2. ACs should be mandated, or encouraged by "best practice" guidelines, to periodically **evaluate** rotation of the audit firm, at least every 10 years, and to address this evaluation in its proxy statement. The evaluation is NOT to be interpreted as an assumption to rotate. The AC evaluation of the capabilities of the firm and assessment of independence would be part of that dialogue. Successful audit firm relationships of 50 years or more have existed without issue of any kind. In many cases, critical information on issues, problems, fraud, errors ,background, etc. is obtained via a stellar communication relationship developed over many years that completes the audit process. So familiarity (apparent "coziness") can be a good thing, not a bad one. It need not adversely affect professional skepticism and audit quality.

3. The AC should be encouraged by best practice to evaluate every 3/5 years the engagement of another firm of audit and accounting consultants, reporting to the AC, on audit and accounting and financial reporting and disclosure risks within the registrant. The need for and accomplishing this task should also be addressed in the AC proxy report. The

scope, depth and focus of the engagement is to be determined by the AC, based on their own comfort with the actions and capabilities and communications with external and internal auditors and financial management, with the objective being to absolutely ensure that any and all issues are on the table for evaluation.

4. The focus of my comments next shifts to the Audit Firm.

A. . I suggest strong consideration to revising specific audit partner rotation rules, lengthening to 10 years for the lead partner, but shortening the rotation of the National Office-assigned review partner to 3/4 years. Too much knowledge and benefit was lost by reducing the pre-SOX 7 year rotation requirement to the current 5 year requirement. Audit costs rose as a result, disruption to trusted relationships and communications were impacted, lives and career paths of audit professionals and the quality of audits were changed not necessarily for the better. Limiting the review partners from becoming lead partner upon rotation is also inefficient and detrimental to audit quality objectives. A "cooling off period" should only be a requirement for the lead partner, and National Office must be responsible for the quality reviewing partner assignment to overcome any potential local office prejudices. The Board and audit committee build a relationship with the lead partner that enhances AC oversight of the financial reporting processes and people within the Company. The credibility of the lead partner is important and should not be discarded lightly in the post-SOX world. It was only an occasional problem in the pre-SOX world.

B. All external auditors, staff through managers in particular, annually need to have emphasized their ethical responsibilities as CPAs (or working for a CPA firm), the firm's "whistle-blower" like practices and procedures and confidentiality, and an appreciation for the perception of its role as public watchdog for investors.

C. When a company changes auditors, the departing firm should be mandated, with "safe harbor" protection from confidentiality or slander standards, to communicate to the successor all important points-of-view the predecessor has or had about the company's risks and exposures, the company management of same, historic conflicts of opinion, unresolved conflicts, and management integrity. The successor firm must document, through an appropriate National level, its evaluation of these communications and its confidence in its ability to address such risks as part of client acceptance.

D. The depth, breadth, quantity, technical expertise, experience and local office independence of the concurring/review partner(s) needs to be evaluated and documented against some to-be-developed standards related to total fees, new or pending IPO, profitability, stock multiples or volatility, and international breadth and geography. This would formalize a practice largely considered by most firms and firm divisions presently. Having a lead review partner and supporting cast of other partners or managers might not

be unusual. Having audit firms invest more in this effort and its execution can be a very significant backstop in ensuring audit quality.

E. Lastly, a further supplemental review, at the start of or shortly before the year-end audit work begins, of audit scope and extent of testing might be helpful on complex or targeted audits. A local office auditing technician can do this through review of the audit planning memo, discussion with the audit team about issues and results to date, and, as needed, review of the audit programs. National industry advisors could be involved as deemed appropriate by the firm or the technician.

5. The PCAOB should, in its study of Audit Reports, evaluate the modification of reporting standards to again permit the use of "subject to" opinions. Whether and how this may be better than "matter of emphasis" paragraphs needs to be a critical part of the evaluation. The objective would be similar, but focus on the auditing difficulties as opposed to disclosure matters. It may still accomplish the objective of highlighting valuations that are very difficult to evaluate or quantify with a considerable degree of accuracy or certainty (or other very subjective areas or areas very broadly impacted by future operations). The objective seems to be to point out to users the issues and disclosures that need to be read and considered, sharing in some efficient way the key audit risks and valuation difficulties. An "auditor's discussion and analysis" is not an efficient way to do so, and shifts inappropriately the burdens of disclosures to the auditors. Emphasis paragraphs may also place the burden incorrectly for disclosing risks and uncertainties. That responsibility rests with management. If emphasis paragraphs are used primarily for cross reference to key footnotes or paragraphs, their use may be helpful but unfortunately diminish the importance of all other footnotes. How **much** audit scope to unveil in presumably informing investors about valuation or recovery or liability audit approaches would be a challenge in assessing value. Audit programs are hundreds of pages and audit planning memos can be 25 to 100 pages. Keeping some secrecy about audit scope used to be desirable to ensure management could not devise plans to circumvent testing or hide transactions. The ongoing year after year quarter after quarter dialogue between auditors and the AC make scope review practical at that level, not for a new or periodic or annual reader. The political issues between the registrant and its auditor on emphasis paragraphs or opinion modifications need to be addressed, so that such uses become more standard and their mere presence does not adversely affect the market's perceptions of the company.

Audits are not insurance nor guarantees. The investing public needs to be better educated about the imperfect and testing nature of auditing and asset valuation, and the perspective of historical point-in-time conclusions vs. being able to predict future outcomes. Some concept of "caveat emptor" needs to be restored in our courts as opposed to always protecting individuals from themselves.

I believe I have a voice that should be considered. I worked in public accounting for 35 years, with Ernst & Young, in 3 different cities. I served as audit partner on many registrants, in and out of the financial services industry. I also played a significant role within E&Y as an "independent reviewing partner", as they were known at the time, on many registrants and IPOs, particularly in the insurance industry. I retired in 2003, and have served as a member or Chair of two audit committees of registrants, one a NASDAQ company and one listed on the NYSE, both insurers, and one mutual insurance company. I well understand the operations of CPA firms and audit committees, and the needs of investors. I follow closely the activities of the PCAOB and the Board and investor community at large. And I appreciate the opportunity to share my opinions and observations.

I appreciate any consideration you may give to my opinions and experiences. I answer the questions you raise in a separate letter.

Very truly yours,

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