



台灣積體電路製造股份有限公司
Taiwan Semiconductor Manufacturing Company, Ltd.

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By EMAIL to comments@pcaobus.org

December 7th, 2011

To: Public Company Accounting Oversight Board ("PCAOB" or "Board")
Office of the Secretary
1666 K Street, N.W.
Washington, DC 20006-2803, U.S.A.
PCAOB Rulemaking Docket Matter No. 37

Dear PCAOB,

As a foreign private issuer listed on the New York Stock Exchange, Taiwan Semiconductor Manufacturing Company Ltd. ("TSMC"¹) hereby respectfully submits its comments on the approach to require mandatory audit firm rotation ("Proposed Approach") as proposed in the Board's Concept Release No. 2011-006 issued August 16, 2011 ("Concept Release") as well as suggested recommendations.

¹ TSMC's corporate governance regime is renowned internationally because we have earned a reputation for excellence in accounting and financial transparency. In addition to working with all of our stakeholders and regulators, TSMC enjoys a robust professional relationship with our independent auditor, who is encouraged to exercise their professional skepticism throughout their tenure. Our audit committee composed of independent directors and financial expert consultant ensures professional auditing independence because only they have the power to hire, fire and manage the audit engagement. Due to limitation of space, it is not practical to list all of TSMC's corporate governance awards. For example, in 2011, Taiwan Semiconductor Manufacturing Company (TSMC) set a record by sweeping the *IR Magazine* Greater China Awards, picking up seven awards in total, making TSMC the only company (since *IR magazine* began awarding the leading IR practices in the region), to have won so many awards, including the grand prix for the best overall IR in Greater China, the best IR by a Taiwanese company and individual awards for best IR officer in Taiwan and best IR by a CFO in Taiwan. In 2010, TSMC has won international recognition when *Corporate Governance Asia* honored TSMC with its "Corporate Governance Asia Annual Recognition Awards 2010". *FinanceAsia* Magazine ranked TSMC's corporate governance as the best among all companies with its "Best Corporate Governance" for the Taiwan region.

I. The PCAOB risks acting outside of its rulemaking powers if it adopts the Proposed Approach in the absence of congressional authority. Also, any rule that purports to bind foreign private issuers without express congressional mandate violates recent U.S. Supreme Court precedent.

A. The U.S. Congress already rejected adopting such an approach and it seems undemocratic for an unelected administrative agency to adopt it.

The legislative history of the Sarbanes-Oxley Act (“SOX”) shows that its congressional drafters specifically considered mandatory audit firm rotation to reform the public accounting profession and contemplated adding such a requirement in SOX. However, Congress deleted such a requirement in SOX². It would be highly irregular for an administrative agency to adopt a rule (especially one that has far-reaching negative effects to be discussed herein) which the U.S. Congress itself had specifically considered and later rejected its adoption. Doing so would therefore be violating the expressed will of elected Congressional representatives.

B. The Board may lack jurisdictional basis to enact the Proposed Approach.

The Board seems to lack the statutory authority to impose any rule requiring mandatory audit firm rotation because neither SOX, the Dodd-Frank Act nor any other act of Congress grants the Board specific authority to require listed companies to periodically switch their independent audit firm³. Instead, Congress itself had considered and later rejected adopting such an approach.

It is noteworthy to know that those foreign jurisdictions that have enacted mandatory audit firm rotation did so through formal legislative enactments. Spain’s 1988 Audit Law was passed by the Spanish Parliament (before being repealed in 1995)⁴. Italy’s requirement

² Instead, Congress required only the periodic rotation of the audit partner.

³ See recent complaint of *Chamber of Commerce of the United States of America, et al. v. National Labor Relations Board, et al.* (Sept. 19, 2011, page 5) challenging the lack of express statutory authority for the NLRB to enact union rights notice requirement. This complaint follows a long-line of recent successful administrative lawsuits against government agencies filed by U.S. business groups. See latest victory of U.S. Chamber of Commerce against the U.S. SEC overturning the later’s proxy access rules. The SEC also has expressed publicly its concern that its conflict minerals rules (which is over 7 months due) would face a similar fate.

⁴ N. Gomez Aguilar, N. Carrera, E. Barbadillo, and C. Humphrey, *Mandatory Audit Firm Rotation in Spain: A Policy That was Never Applied*, 1, 6 (working paper) (2006)

is also statutory⁵. Likewise, Korea's requirement was also passed by its National Assembly in 2003⁶.

C. Recent U.S. Supreme Court case suggest that only Congress has the constitutional power to enact laws with extraterritorial application.

Many foreign private issuers worldwide are publicly listed within the U.S. Therefore, the Board must consider whether its rules may constitutionally be permitted to apply extraterritorially. Based on recent U.S. Supreme Court precedent, it seems that only Congress has the constitutional power to legislate laws with extraterritorial effect.

In June 2010, the U.S. Supreme Court set forth a canon of statutory construction by ruling that any Congressional intent to give laws extraterritorial effect must be clearly and expressly stated. As Justice Scalia wrote, “[w]hen a statute gives no clear indication of an extraterritorial application, it has none.” *Morrison v. National Australian Bank*, 561 U.S. ____ June 24, 2010) (No. 08-1191) at page 6⁷.

If an act of Congress must expressly state whether its has extraterritorial effect to pass Supreme Court review, then how much more difficult would it be for the Board's enactment of the Proposed Approach to pass the simplest of judicial review. Even if the Board can show that it has specific statutory authority to enact the Proposed Approach, it would be almost impossible for the Board to prove that Congress made an “affirmative intention” for the Proposed Approach to apply extraterritorially (short of an act of Congress expressly saying so).

The law aside, without express congressional support, the PCAOB lacks the *de facto* ability to operate effectively outside the U.S. at all. For example, in July 2011, the Board was unable to agree upon a standard set of cross-border auditing standards with its Chinese counterparts. The Chinese regulators flatly rejected the Board's request to investigate a list of

⁵ S.Y. Kwon, Y.D. Lim, Roger Simnett, Mandatory Audit Firm Rotation and Audit Quality: Evidence from the Korean Audit Market 1, 7 (November 2010)

⁶ *Ibid* at p.11

⁷ The Supreme Court held that “it is a ‘longstanding principle of American law ‘that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States.’ *EEOC v. Arabian American Oil Co.*, 499 U. S. 244, 248 (1991) (*Aramco*) (quoting *Foley Bros., Inc. v. Filardo*, 336 U. S. 281, 285 (1949)). It rests on the perception that Congress ordinarily legislates with respect to domestic, not foreign matters. *Smith v. United States*, 507 U. S. 197, n. 5 (1993). Thus, ‘unless there is the affirmative intention of the Congress clearly expressed’ to give a statute extraterritorial effect, ‘we must presume it is primarily concerned with domestic conditions.’ *Aramco*, *supra*, at 248 (internal quotation marks omitted).

Chinese public companies in order to protect China's sovereignty⁸.

This fact illustrates the *de facto* lack of the Board's regulatory authority to address the international aspect of the audits of almost all large global issuers. The Board is simply not in a position to compel rotation without causing counterproductive consequences such as imposing securities trading prohibitions on the U.S. exchanges, or violating the jurisdiction of foreign securities and accountancy regulators.

II. The Proposed Approach undercuts both audit efficiency and effectiveness.

The market rejected the idea of mandatory audit rotation when it was first introduced in the U.S. during the 1970s (when there were eight large audit firms) because its costs would exceed the benefits. Over thirty years later, the market still believes the idea to be bad especially when there are now only four large audit firms.

SOX section 207 required the U.S. comptroller general to conduct a study to review the potential effects of requiring mandatory rotation of registered public accounting firms. The subsequent 2003 GAO Study discussed above concludes that the benefits of mandatory firm rotation were not certain and that more experience with the effects of SOA's other requirements was needed. Most importantly, the study also acknowledged that the overwhelming majority of the CFOs (88%⁹) and audit committee chairs (90%¹⁰) of U.S. Fortune 1000 public companies and public audit firms, who were surveyed, opposed mandatory audit firm rotation.

They object to mandatory audit rotation because it would decrease:

1. audit efficiency because management would need to spend time and money educating new incoming auditors and "get them up to speed"¹¹ which in turn would increase the risk of undiscovered fraud or mis-accounting¹²; and
2. audit effectiveness because the new incoming audit firm would not have any accumulated knowledge and experience about their client that would have provided a

⁸ *U.S. and China Fail to Agree on Cross Border Auditing Standards*, Aug. 8, 2011 businessinsider.com/us-and-china-fail-to-agree-on-cross-border-auditing-standards-2011-8

⁹ GAO Report at p. 141

¹⁰ *Ibid.*, p. 155

¹¹ *Ibid.*, p. 159

¹² *Ibid.*, p. 132

keener insight into their client's accounting matters¹³. Audit failure rates have been demonstrated to be higher when the auditors are new and have not yet developed the accumulated knowledge necessary for a comprehensive audit.

Another factor reducing audit effectiveness is the hindsight judgment that a prior audit mistake might require correction. The issuer will be in no position to force the now-discharged prior auditor back onto the assignment to re-issue another report. Yet the current audit firm will be in no position to re-perform stale work – at least not without incurring time and cost on the current assignment.

Nine years after the publication of the GAO Study, worsening global business conditions in 2011 merely have exacerbated the concerns expressed in the Study. At a time when many debt-ridden European countries face grim economic futures, the U.S. hangs on the verge of a double-dip recessions after having its treasury bills downgraded and Africa and the Middle East mired in revolutionary fervor, imposing a rule whose expected costs exceeds its perceived benefits may be the final straw that may break the proverbial camel's back.

III. The Proposed Approach offends traditional notions of fair play and justice because it would be impossible for large public companies to comply with.

For any rule to be fair, it must be possible to comply with it. A rule that makes compliance nearly impossible would be “arbitrary and capricious”. Large public companies like TSMC would be unable to comply with the Proposed Approach because the “Big Four” accounting firms have a virtual tetrapoly on the market for audit services. There simply isn't enough competent audit firms for large companies to retain. This is because large public companies expect their accounting records to be audited by audit firms which have competent staff to be able to understand their complex business. Because of insufficient resources, small to medium audit firms will unlikely accept assignments to audit large public multinational companies even if such assignments were handed to them on the proverbial silver platter.

In reality, the audit committees of large public company must choose from the Big 4 firms, because only they have the perceived resources and competency to tackle difficult multinational audit assignments. But since there are only four of these audit firms, there simply would not be enough audit firms for large companies to rotate through. Simply put, the Board is asking large companies to play the game “musical chairs” with four chairs only. The likely result would be that many large companies would be left standing in the cold.

For example, TSMC, engaging one Big Four firm for our audit, will necessarily disqualify another firm that is retained for non-audit services (like tax advisory), and a third firm that provides audit services or non-audit services to our major competitors based in Taiwan. Possibly a fourth firm (or more) would need to be disqualified depending on the business needs of the large issuer, such as the need to protect its trade secrets and other proprietary information from being misappropriated through sharing a Big Four audit firm with its competitors.

At least two major government reports on mandatory audit firm rotation highlights the lack of choice of audit firms necessary to allow compliance. For example, the U.S. Government Accountability Office, issued in November 2003, its report *Public Accounting Firms: Required Study of the Potential Effects of Mandatory Audit Firm Rotation* (as required by Congress under SOX) in which it surveyed CFOs and audit committee chairs for Fortune 1000 companies, audit firms and other key players (“GAO Report”).

One of the key concerns cited by industry in the GAO Report was the lack of choice of audit firms, as one commentator from Tier 1 Public Accounting Firm noted that:

“if Firm A provides internal audit services, Firm B provides another prohibited nonaudit service and Firm C is the audit firm - the only other firm that could serve as the auditor of the issuer would be Firm D. So an issuer, rather than choosing among the three other top tier firms to rotate, would have only one realistic firm to rotate in as its audit firm, unless it considered next tier firms. To further highlight this potential issue - it is possible that Firm D may not have the industry expertise desired by the issuer. As a result, the issuer - in order to comply with mandatory firm rotation - could be forced to choose an audit firm that does not have the optimum level of industry expertise¹⁴.” [emphasis added]

As a company based in Taiwan, the Proposed Approach presents TSMC with additional problems. There are not enough qualified auditors who are able to understand local Taiwan and U.S. GAAP, GAAS and IFRS on top of being fluent in both Chinese and English as well as being able to function efficiently in a multinational corporation. For example, one commentator from Tier 1 Public Accounting Firm in the GAO Report noted that:

“The strain is even greater in the case of firms in foreign countries. Personnel

¹⁴ U.S. General Accounting Office, *Required Study on the Potential Effects of Mandatory Audit Firm Rotation*, 116, (2003) (“GAO Report”).

The other report was commissioned by the U.K. government that also discussed the issue of lack of audit firm choice, noting that “in many cases the effective choice is perceived to be less than four firms if, for example, one or more firms are ineligible for appointment as auditor due to auditor independence rules or due to a company’s own policies and procedures.” Financial Reporting Council, *Discussion Paper: Choice in the UK Audit Market*, 3 (May 2006).

in foreign locations must have sufficient facility with U.S. GAAS and GAAP [now also IFRS] as well as the language skills and cultural awareness to work with the rest of the audit team. Relocations of suitable personnel for engagement purposes would be expensive and might not be possible due to local licensing and similar requirements. For these reasons, mandatory rotation of audit firms, by increasing the frequency that new teams must be assembled for new audits, would make it harder to align expertise in overseas offices to the needs of audits of multinational U.S. companies¹⁵.”

Who knows how many of the Big 4 firms will remain in the near future. All of the Big 4 firms are currently facing accusations about their auditing standards by investors who collectively seek to recoup billions of dollars lost in the financial meltdown. For example, one Big 4 firm is facing a whopping US\$7.6 billion lawsuit filed in September 2011 for allegedly failing to detect fraud during its audits of one of the biggest private mortgage firms to collapse during the U.S. housing crash¹⁶. If any one of them were to disappear in the future, then the problems flowing from the lack of choice of audit firms will be compounded many times over, making it even more impossible to comply with mandatory audit firm rotation.

IV. The Proposed Approach needs to consider its effect on prevailing local conditions of foreign private issuer home countries.

It is arbitrary and capricious for a rulemaking agency to “entirely fail[] to consider an important aspect of [a] problem.” (See complaint of *Business Roundtable, et al. v. SEC* (Sept. 29, 2010) citing *Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983)). We therefore urge the Board to consider the effects of the Proposed Approach on local conditions prevailing within Taiwan, which is TSMC’s home jurisdiction.

The Proposed Approach cannot come at a more inopportune time in Taiwan. Taiwan accounting rules are currently undergoing a systemic change as local companies prepare for the transition from Taiwan GAAP to Taiwan IFRS. Large publicly listed companies like TSMC are required to use Taiwan IFRS on January 1, 2013. We have spent the past few years working with our audit firm and our independent audit committee on the particularities of how Taiwan IFRS would affect our complicated accounting matters as well as our international reporting obligations which often require complex translations among U.S. GAAP, Taiwan GAAP, U.S. IFRS, international IFRS, and Taiwan IFRS.

These are tasks that falls on top of our already complex financial and accounting affairs that we have to solved on a day-to-day basis. Preserving the continuity of our audit firm staff, as well as their accumulated knowledge and experience on our global operations and financial dealings is absolutely critically important in helping us ensure: (i) a smooth transition to local IFRS; and (ii) accurate reporting in our periodic Taiwan and overseas

¹⁵ GAO Report at p.120

¹⁶ *Deloitte sued for \$7.6 billion, accused of missing fraud*, September 27, 2011, Reuters, <http://www.reuters.com/article/2011/09/27/us-deloitte-mortgage-idUSTRE78P51E20110927>

reporting obligations.

Requiring us to change our audit firm at this critical juncture of local IFRS transitioning is extremely counter-productive to our shareholders and stakeholders who rely on management and the audit committee to ensure complete financial and accounting transparency.

The concern about the counter-productive timing of a required audit firm change is also shared by the chairs of audit committees on U.S. Fortune 1000 companies who discussed this issue in the GAO Report, noting that:

“[m]andatory audit rotation could result in a change of auditors at a time that would be counterproductive for the audit firm and the company¹⁷”

“mandatory change of auditors in midst of strategic shifts/mergers or acquisitions could impair business¹⁸”

“[s]ince the timing of the change would not be under t h e control of the audit committee, it could come at a time when the expense of a change would be inordinately high, such as during a major acquisition, recapitalization, or restructuring¹⁹”

Requiring us to change our audit firm in the midst of a major overhaul of our home country accounting standards to IFRS is tantamount to requiring us to change our audit firm in the middle of a major strategic corporate event, with all the associated risks and costs of audit errors.

V. Recent 2010 empirical study from a mandatory audit firm rotation environment indicates that the perceived benefits of the Proposed Approach does not outweigh the costs.

The Board would be hard-pressed to find one study that shows that the length of audit tenure is at all coincidentally related to issues of audit quality, much less that there is any causal relationship between the two²⁰. Simply put, there isn't a whole lot of evidence that audit firm rotation will work. Supporters of the Proposed Approach point to Italy, which enacted the rule. Rather than supporting the Proposed Approach, the Italian experience

¹⁷ GAO Report at p. 141

¹⁸ *Ibid.*

¹⁹ *Ibid.*

²⁰ At best, the evidence is mixed. See *Evidence is mixed about if it's an effective way to boost independence, objectivity*, CFO World, September 5, 2011 <http://www.cfoworld.co.uk/news/governance/3301401/will-mandatory-us-auditor-rotation-help/>

shows instead that mandatory audit firm rotation proved ineffective in Italy to prevent one of Europe's biggest financial and accounting scandals when the Italian publicly listed giant Parmalat collapsed in 1999 into an ocean of accounting fraud undetected by the successor audit firm newly rotated in.

On the other hand, there are reams upon reams of studies showing that mandatory audit firm rotations is counterproductive. But in its Concept Release, the Board dismissed all of these empirical studies (that have been historically relied upon by opponents of the Proposed Approach) as being suspect (and therefore irrelevant) because these studies "focus on environments where auditor rotation is voluntary rather than mandatory²¹."

A ground-breaking study²² of the Korean audit market (which is a jurisdiction that enacted mandatory audit firm rotation in 2006) performed in 2010 focused on empirical data from an environment where auditor rotation was mandatory, (just the kind of study that Board said was missing to undermine the Proposed Approach). This study is unique because it examined the impact of mandatory audit firm rotation on audit quality under a mandatory audit firm rotation jurisdiction. Second, this study is the first to use an extremely rich set of dataset (from a database of 12,463 firm-year observations in Korea from 2000 to 2007) of audit hours and audit fees.

This study shows, through empirical data and calculations, that, since the Korean government mandated audit firm rotation in 2006: (i) audit hours increased; (ii) audit fees increased; (iii) audit quality (measured as abnormal discretionary accruals) remained unchanged or decreased slightly²³. The study suggests that mandatory audit firm rotation increases the cost for audit firms and clients while having no discernable positive effect on audit quality.

VI. The Board ought to enact rules that are directly related to improving audit firm independence.

The Board is concerned about audit firms being pressured into agreeing with management during their tenure. However, there is simply no causal connection between mandatory audit firm rotation and removing these pressures because "[m]andatory audit firm rotation is not a panacea that totally removes the pressures on the auditors in appropriately resolving financial reporting issues that may materially affect the public companies' financial statements. These inherent pressures are likely to continue even if the term of the auditor is limited under any mandatory rotation process²⁴. [emphasis added]".

²¹ Concept Release, at p. 16

²² S.Y. Kwon, Y.D. Lim, Roger Simnett, Mandatory Audit Firm Rotation and Audit Quality: Evidence from the Korean Audit Market (November 2010) ("2010 Korean Study")

²³ *Ibid.* at p. 3

²⁴ Governing the Corporation: Regulation and Corporate Governance in an Age of Scandal and Global Markets, (John Wiley & Sons, Ltd. 2005) edited by Justin O'Brien, p.39

In other words, close relationships are bound to occur between the audit firm and its client regardless of the length of the audit relationship. If so, imposing any mandatory rotation period would not fix the problem. Instead, the Board should enact rules that are directly related to improving audit independence, such as the following recommendations.

- Rely on existing SOX and Dodd Frank Act protective measures.

Every jurisdiction that has adopted the Proposed Approach is a country that has less-developed capital markets, fewer investor protections and less effective enforcement mechanisms relative to the U.S. Unlike these jurisdictions, the U.S. has been the leader in enacting protective measures in both SOX and the Dodd Frank Act designed to ensure accounting transparency. For example, SOX requires periodic rotation of the audit partner and whistleblowers of accounting irregularities are incentivised to report to the SEC in return for bounties of up to 30% of the final award. Most importantly, management are simply not in the position to retaliate or otherwise influence its audit firm because the power to retain or fire the audit firm rests solely in the hands of the company's audit committee comprised of independent directors under SOX. The supposed benefits of the Proposed Approach can just as well be obtained via use of presently enacted SOX-Dodd Frank measures.

- Subject the accounting profession to more rules that increase professionalism without burdening non-accounting related industries.

Mandating rotation does not guarantee auditor independence. Instead, professionalism does. Therefore, the PCAOB should instead make rules that would increase or ensure auditing professionalism such as:

- (i) requiring additional continuing educational classes on the importance of independence for auditors;
 - (ii) increase testing on independence in the professional exams required to be taken by auditors;
 - (iii) require audit firm partners to establish an "Independence Committee" to review periodically the adequacy of the audit team independence; and
 - (iv) require an audit firm to rotate out only if its client has been found guilty of major accounting wrongdoing or if the audit firm has failed Board inspection audits.
- Check with the U.S. Department of Justice on whether the Proposed Approach would encourage collusive effects and practices in the auditing industry.

Assuming the Board is adamant about enacting the Proposed Approach, we also

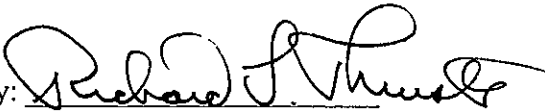
recommend that the Board check whether this approach would encourage collusive practices in the audit industry. A 1997 report²⁵ concluded that mandatory audit firm rotation would create a system in which audit firms would 'take turns' at performing the audit. This, the report argued, would result in an artificial division of the market and would encourage collusion among audit firms, reducing the number of practicing audit firms even further. More importantly, the report concluded that rotation was likely to reduce the incentive for audit firms to invest and compete in providing a top quality audit, as firms doing so would have to 'relinquish their achievements periodically'. An analysis based on anti-trust rules is beyond the scope of this letter. It is recommended that the Board seek advice from the U.S. Department of Justice, Antitrust Division for comments on such effects on the auditing market.

- The Board should exempt from the Proposed Approach audit firms working on assignments with foreign private issuers.

As is customary when proposing major rules, it is within the Board's authority to grant an exemption when the audit firm is working on engagements with foreign private issuer clients, especially when there is no congressional expressed intent that the Proposed Approach apply extraterritorially. For the reasons stated above, we respectfully request that the Board grant such an exemption.

Sincerely,

On behalf of Taiwan Semiconductor Manufacturing Company Ltd.

By: 
Title: Senior Vice President & General Counsel
Date: DECEMBER 7, 2011

²⁵B. Arrunda and C. Paz-Ares, *Mandatory Rotation of Company Auditors: A Critical Examination*, International Review of Law and Economics 17, 31-61.