

December 07, 2011



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

Re: PCAOB Rulemaking Docket Matter No. 37

Ladies and Gentlemen:

The AES Corporation  
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### **Introductory Comments**

The AES Corporation (NYSE:AES) is a Fortune 200 global power company with over 100 generation and distribution businesses, with operating capacity of over 42 GW annually. Through our diverse portfolio of thermal and renewable fuel sources, we provide affordable and sustainable energy to 28 countries. Our workforce of 29,000 people is committed to operational excellence and meeting the world's changing power needs. Our 2010 revenue was \$17 billion and we own and manage \$41 billion in total assets.

Following the passage of the Sarbanes Oxley Act of 2002, AES made significant organization, system and process changes to improve our controls and accuracy of our financial reporting. These changes included the voluntary replacement of our external audit firm, with whom the Company had worked since its inception, 25 years prior. Our experience and history indicated it was time for a change, and a fresh set of perspectives. AES Executive Management as well as the Board of Directors was very supportive of the change, despite the six months it took to run the process, and another 12 months before the replacement firm was fully on board. We believe that this process and Audit Committee support has fostered an environment which strongly reinforces the importance of the auditor's role. By comparison, we already face mandatory auditor rotation at one of our large international subsidiaries, which is fraught with inefficiency and delays. As a result, we have first hand experience at the challenges mandatory auditor rotation brings, with no apparent benefit we have been able to determine.

We support efforts which will strengthen the conduct of audits. However, we feel strongly that mandatory audit firm rotation should not be required and will not strengthen the conduct of audits. Any decision to do so should be supported by clear analysis which support that the benefits of doing so out-weigh the costs, both tangible and intangible. The level of effort required to change auditors is extensive for a company, its Audit Committee, and auditors and should not mandated merely by the passage of time, but should be based on facts and circumstances which warrant such a change is in the best interest of the shareholders.

We appreciate the opportunity to provide a response to the Concept Release on Auditor Independence and Audit Firm Rotation. Our comments are focused on select questions

that allow us to further clarify why we do not believe mandatory audit firm rotation will strengthen the quality of audits.

### Responses to Selected Questions

- 3. Does audit effectiveness vary over an auditor's tenure on a particular engagement? For example, are auditors either more or less effective at the beginning of a new client engagement? If there is a "learning curve" before auditors can become effective, generally how long is it, and does it vary significantly by client type?**

#### Company's Response

As mentioned previously, we changed audit firms after utilizing the same firm for approximately 25 years. This was a very difficult change and entailed an approximately 18 month process including evaluation and selection, shadowing the former auditor and a steep learning curve. While the effectiveness of the audits prior and subsequent to the change was high, the level of effort associated with the change in auditors was significant, both for the company, its Audit Committee and the new audit firm. After nearly four years with the new firm, we are beginning to yield the benefit of their knowledge of our company. There is clearly a learning curve when a new firm is engaged which the firm compensates for by spending more time and asking more questions. Although the "duration" of the learning curve will vary based on the complexities of each company, given the competitive nature of the public accounting firms, these additional costs are typically not recovered and become an investment in the new client. If mandatory rotation was required, it's likely these fees will not be absorbed but instead will be passed on to clients driving higher fees. In addition, the level of effort and time required by the staff of companies is also significantly increased in the early years of an audit relationship with very little corresponding benefit.

We do not believe mandatory audit firm rotation will enhance audit quality instead it will increase costs and reduce the value the company and its investors receive from an auditor with a deep knowledge and understanding of the company. Given the requirements of the PCAOB and the SEC over the conduct of audits, it is also not logical that mandatory audit firm rotation will improve an auditor's independence. There already exists ample incentives for audit firms and their professionals to maintain and execute their "public watchdog" function with the highest degree of quality and independence.

- 4. Some have also suggested that, in addition to being less effective at the beginning of an engagement, an auditor may be less diligent toward the end of the allowable term. On the other hand, others have suggested that auditors would be more diligent towards the end of the allowable term out of concern about what the replacement auditor might find. Would auditors become more or less diligent toward the end of their term? Does the answer depend on the length of the term?**

### **Company's Response**

Auditors have every incentive to be diligent and effective in every year of an engagement, both beginning and end. From a reputational risk, to public/regulatory scrutiny, to profitability, audit firms have no incentive for an audit failure. Prior to mandatory lead audit partner rotation, there was the potential for issues not being addressed as thoroughly as they perhaps should have been, should a particular partner become overly familiar or worse, dependent upon the client's business. This issue has been addressed with mandatory partner rotation of both primary and concurring partners which allows a fresh perspective on the company and transactions. Periodic partner rotation provides assurance that issues are thoroughly vetted given the responsibility of the audit partners for final sign off while continuing to build the knowledge the firm has of its client. However, this same logic does not hold true for rotation of the entire firm. Normal staff turnover and partner rotation introduces sufficient "fresh perspective" to allow high quality audits to occur. Rotation of the entire firm drives significant disruption and eliminates the quality that is derived over time.

- 7. To what extent would a rotation requirement limit a company's choice of an auditor? Are there specific industries or regions in which a rotation requirement would present particular difficulties in identifying an auditor with the necessary skills and expertise? Is it likely that some smaller audit firms might decide to leave the public company audit market due to the level of uncertainty regarding their ongoing client portfolios?**
- 10. Would rotation create unique challenges for audits of multinational companies? For voluntary rotations that have taken place, what have been the implementation and cost issues and how have they been managed?**

### **Company's Response**

For a company of AES' size and global scope, the audit services of a big four public accounting firm are required, given the sheer geographic footprint and technical expertise needed. It is critical to have a firm with the appropriate industry expertise in the locations we operate, as well as the ability to manage local as well as US GAAP and/or IFRS requirements. Similarly, it is also important for us to have big four firms that can assist us with non-audit services. In some cases, because of the relative expertise of certain firms in certain areas, such as financial systems application support, a firm may provide more value to us in a non-audit capacity. This may further limit our options for audit firms and increase the challenge of mandatory auditor rotation.

In certain global locations, such as Brazil, we already face the issue of mandatory auditor rotation at our subsidiaries and have seen no apparent benefit. Given the limited number of qualified audit firms of scale, this requirement has placed form over function, resulting in a hand off between two firms every five years. In the "off" years, this results in duplicate audit efforts as both firms need to take the necessary steps to support their prior and current separate audit opinions. This has proven both expensive and inefficient for all involved.

We have also experienced certain firms declining the opportunity to propose for audit engagements in jurisdictions with mandatory auditor rotation requirements as it would limit the firm's capability to do other non-audit related engagements. None of these factors lead to improved audit quality. In addition, given our use of the other big-four accounting firms for non-audit related engagements, we would have to select a replacement auditor well in advance of a required rotation to ensure the firm is independent. This will penalize the accounting firm by not being able to compete for work in the year prior to the engagement and lead to higher fees by other providers because competition for services has been limited.

**11. Would increased frequency of auditor changes disrupt audit firms' operations or interfere with their ability to focus on performing high-quality audits? How would such disruption vary by firm size? For example, would a rotation requirement pose fewer or more implementation issues for small firms than large ones?**

**Company's Response**

Increased frequency of auditor changes can only lead to a disruption in their operations regardless of the size of the audit firms' operations. Staff retention would likely become an issue due to uncertainty surrounding an ongoing role, which would interfere with an audit's accuracy and ultimately its completion. Staffing of new engagements with qualified personnel may also be challenging given a particular market's resources leading to an increased number of inexperienced personnel on an engagement. Staffing plans and training would need to be modified to focus on shorter time horizons which may also result in reduced bench strength and expertise within the firms. All these factors would naturally lead to lower-quality audits. For smaller firms, this issue would be further exacerbated and perhaps may be competitively prohibitive which may cause them to develop their practices around non-audit related services.

**13. Would rotation have any effect on the market for non-audit services? Would any such affect be harmful or beneficial to investors?**

**15. What effect would a rotation requirement have on competition for audit engagements? If competition would be increased, how might that affect audit quality?**

**Company's Response**

Mandatory auditor rotation will impact the market dynamics of the public accounting profession. Firms will need to weigh the impact of not being able to provide non-audit services with only being able to provide audit services for a limited period of time. For large international firms, the level of effort to become "independent" can be a challenging exercise that may not prove to be desirable in exchange for a limited term audit engagement. There is also a need for auditors to become "independent" after the conclusion of an audit engagement if consents are required in subsequent registration statements. This creates further practice management challenges that may make audit engagements less desirable, especially in light of the risk associated with an audit engagement versus a non-audit engagement.

We believe a significant impact of rotation would be to further limit public accounting firms that would be willing to conduct audits. Recently, in response to mandatory auditor rotation in one of our foreign locations, two of the big-four firms declined to propose because their perceived “opportunity” for non-audit services was greater than the prospects surrounding a limited term audit engagement. As the incumbent is not permitted to propose, only one big-four firm is now proposing. This greatly limits the opportunity to make sure the most qualified firm is providing the audit services. It also will place further responsibility on the U.S consolidated auditor, and cost to the company, to determine if the local firm’s audit procedures can be relied upon or if duplicate audit work would be required by the consolidated auditor which may lead to increased costs for the company.

**17. If the early years of an auditor-client relationship pose higher audit risks than later years, should the Board require firms to provide additional audit supervision and oversight in the first year or two of a new engagement? Should the Board impose such a requirement for auditor changes even if it does not further consider requiring audit firm rotation? If firms are accepting new clients but are unable to provide quality audits for them until several years have passed, should the Board require enhanced client acceptance procedures? What impact would additional requirements of this type have on audit costs?**

#### **Company’s Response**

Given the current risk associated with providing audits, especially in the public company arena, audit firms have every incentive to provide high quality audits every year. Given our recent experience with changing audit firms, the firm made significant investments in its early years to assure that the appropriate level of supervision and oversight was provided. Although additional requirements or guidelines may be suggested by the Board, we find it highly unlikely they are required. The big-four accounting firms have very rigorous client acceptance procedures in place and go to great lengths to ensure that they are physically and technically capable of meeting a client’s quality audit requirements.

#### **Closing Comments**

The PCAOB is to be commended for continuing to evaluate how to assure that investors and other financial statement users are being best served by the audit function. However, it is important to focus on areas that will drive value to investors. We do not believe mandatory auditor rotation provides value to investors, but drives significant cost, delays and inefficiencies. We believe adequate safeguards are already in place to address the concerns that the PCAOB has raised. Mandatory lead audit partner rotation, coupled with normal audit staff turnover, already greatly reduces the potential for governance risks (and poor quality audits) which might otherwise arise from an auditor being overly familiar with a client. We also believe that risks inherent in

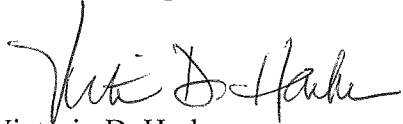
auditing public companies in the current environment, which was greatly decreased by the Sarbanes-Oxley Act, provides little incentive for firms to conduct audits with anything less than full transparency and professional scrutiny

What mandatory auditor rotation will do is drive increased audit fees, inefficiencies and lengthy process changes, resulting in questionable value. It will also limit the options companies have in selecting audit firms which could lead to reduced audit quality.

We appreciate the opportunity to provide comments on certain elements of the Concept Release and we look forward to your further deliberations.

Respectfully yours,

The AES Corporation

A handwritten signature in black ink, appearing to read "Victoria D. Harker". The signature is fluid and cursive, with a large initial "V" and "H".

Victoria D. Harker  
Executive Vice President and Chief Financial Officer