McGladrey

McGladrey & Pullen, LLP
Certified Public Accountants

3600 American Blvd West
Third Floor
Bloomington, MN 55431
O 952.835.9930 **F** 952.921.7704
www.mcgladreypullen.com

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

RE: PCAOB Rulemaking Docket Matter No. 37

Dear Office of the Secretary:

McGladrey & Pullen, LLP appreciates the opportunity to comment on the PCAOB's *Concept Release on Auditor Independence and Audit Firm Rotation.* McGladrey & Pullen is a registered public accounting firm serving middle-market issuers, brokers, and dealers. Our comments are organized by those that are general in nature regarding auditor objectivity, followed by those that relate to certain matters on which the PCAOB sought comment in the Concept Release.

Objectivity Is Critical to the Viability of Auditing as a Profession

The focal point of the PCAOB's *Concept Release on Auditor Independence and Audit Firm Rotation* is the principle of auditor objectivity. The quality of an audit is built on the competence, independence, integrity, and objectivity of the people who perform the audit. It therefore is imperative that accounting and auditing issues be evaluated with the objectivity and skepticism called for by professional standards. Auditors distinguish themselves by having the ability to consistently make high-quality judgments with an independent mindset. This is where our profession adds value to the capital markets. We do not intentionally arrive at judgments that are not objective. When that does happen, there are serious consequences.

Substantially all auditors are personally committed to the principle of objectivity. Although auditors are bound by a code of ethics that requires it, the exercise of objectivity cannot be legislated through a set of rules that purport to mandate those qualities. Auditors realize that a lack of independence, objectivity, or professional skepticism can have dire consequences, not only for their firm, but also for them personally. Auditors are subject to state laws that generally require CPA firms be owned by individual CPAs. Therefore personal financial resources of our partners are at stake with each audit opinion we sign. Also, a state board of accountancy can suspend or revoke a license to practice if a complaint regarding the auditor's professional conduct is received and found to be valid. Further, both the SEC and the PCAOB can prohibit a CPA from providing services for SEC registrants as a result of an investigation into the auditor's professional activities.

Registered public accounting firms spend significant resources on quality control systems and programs to promote independence, objectivity, and professional skepticism. The requirements for a periodic change in the engagement partner in charge of the audit and the requirement for an engagement quality review necessitate tremendous expenditures of partner time. These requirements, however, provide effective opportunities for bringing a fresh viewpoint to the audit. Audit firms also spend enormous amounts of time and resources conducting their own internal inspections and responding to the inspections of the PCAOB.

The expenditure of resources, both personally and as a profession, in upholding the exercise of objectivity is merely an indication of its importance. Auditors understand that objectivity is critical to the viability of auditing as a profession. Objectivity is a tenet of our profession, and it is what sets our chosen vocation apart from others.

Investor surveys continue to indicate that the independent auditor remains the most trusted participant in the financial reporting process. It is a recognition that we place at the top of our priorities, is essential to our brand, and motivates us to perform our duties at the highest levels of integrity.

Mandatory Audit Firm Rotation Would Not Serve the Board's Goals of Protecting Investors or Enhancing Audit Quality

The PCAOB selects the audits for inspection that it believes present the highest risks and then reviews the areas within each audit that are the most complex and challenging. Inspections are designed to identify and focus on potential audit deficiencies. In Part III.C. of the Concept Release, the PCAOB stated the following regarding the limitations of its inspections data, "Preliminary analysis of that data appears to show no correlation between auditor tenure and number of comments in PCAOB inspection reports." We agree that the PCAOB should further analyze its inspection results and other available information to determine whether audit deficiencies truly are attributable to a lack of auditor objectivity or professional skepticism and further whether any such lack of objectivity or professional skepticism is attributable to auditor tenure.

The root causes of audit failures are complex and vary in nature. Mandatory audit firm rotation is not necessarily a solution to those causes. Even the PCAOB does not suggest that all of the audit failures or other audit deficiencies its inspections staff has detected necessarily resulted from a lack of objectivity or professional skepticism. If auditors approach the audit of highly judgmental balances by seeking to obtain evidence that corroborates rather than challenges the judgments made by their clients, mandatory audit firm rotation would not be a logical solution to that problem. Auditors need to exercise professional skepticism and objectivity in seeking out and evaluating available audit evidence regardless of whether it corroborates or contradicts management's assertion and regardless of engagement tenure.

Moreover, because audit engagements with short tenure are relatively riskier than those with a longer tenure, mandatory audit firm rotation could contribute to a decrease in audit quality. Audit quality may suffer in the early years of an engagement because the auditor does not understand the client's business as fully as he or she does in subsequent years after more experience with the client. The Cohen Commission reported that in its "study of cases of substandard performance by auditors, several of the problem cases were first- or second-year audits." Also, according to a survey by the Government Accountability Office, 79% of larger audit firms and Fortune 1000 companies believed changing audit firms increases the risk of an audit failure in the early years of the audit.

Our Firm's inspection results show no correlation of substandard performance with client tenure. In fact, a root cause for some of our inspection findings has been determined to be an inadequate understanding of the client's business model and the risks associated with it. Mandatory audit firm rotation would only exacerbate this problem. Having a long-term relationship with a client should not breed a lack of objectivity. Rather, we believe we are more effective auditors when we have a deeper understanding of the client's business model.

Professional auditing standards require the auditor to gain an understanding of the client that is sufficient to plan and perform an effective audit. There is a certain amount of learning time necessary to gain the familiarity with a company and its operations that is necessary for an effective and efficient audit. Mandatory audit firm rotation would result in the loss of vast stores of institutional knowledge and guarantee that auditors would be climbing a steep learning curve on a regular basis, especially in audits of multi-national companies where there are many people involved in learning and understanding the business complexities. Rotating the entire engagement team actually creates a greater risk from an audit quality perspective because new auditors need to learn about the client's business, accounting processes, complex transactions, *etc*.

Ending a firm's ability to have a long-term relationship with a client would increase the amount of time and resources auditors spend proposing to enter new client relationships. This could lead to an unintended consequence of stretching already scarce resources even more and put at risk the amount of time auditors have to focus on audit quality. The competition that would result from mandatory audit firm rotation could actually decrease the amount of fees that a firm obtains in an audit as audit firms aggressively pursue replacement business. This could result in the unintended consequence of a decrease in audit quality because the amount of fees might put undue pressure on the number of budgeted audit hours committed to an engagement.

Mandatory audit firm rotation could result in other unintended consequences that decrease audit quality. For example, in certain industries, there are a limited number of firms with the requisite specialization to serve clients. Mandatory audit firm rotation could result in an issuer being audited by a firm that does not have the level of industry specialization needed. Geographic constraints also may narrow the field of eligible registered public accounting firms that are able to serve a particular issuer. Realistically, there will be problems associated with the need to transfer audit firm employees to other locations.

Practically speaking, for the largest issuers, there are many instances of independence conflicts that prevent the other Big 4 firms from being considered as a new auditor. If auditor rotation is required, there may not be any other qualified firms to propose to audit the largest issuers. In these cases, since the largest issuers do not have another audit firm to turn to, there is no basis for an auditor to lose its focus on objectivity for fear of losing the client.

Our Views on Other Measures that Could Meaningfully Enhance Auditor Independence, Objectivity, Professional Skepticism, and Ultimately Audit Quality

Because of the lag time in the reporting of PCAOB inspection results and in the implementation time for new auditing standards, the PCAOB should give current reforms time to work their way through future audit engagements and thus enhance audit quality. Through the quality control remediation process, the PCAOB's findings have led to numerous and significant improvements in firm audit methodologies, processes, and related quality control systems. We have noticed an increase in the quality, depth, and tenacity of the PCAOB inspection teams over the years. The thoroughness of these inspections has improved audit quality. A by-product of this process has been an increase in the quality of our internal inspectors and our inspection program, which in turn also has improved audit quality.

The PCAOB has issued a number of important auditing standards and guidance recently that bear directly or indirectly on auditor objectivity and professional skepticism. In August 2010, the PCAOB adopted a suite of eight auditing standards related to the auditor's assessment of, and response to, risk in an audit. In July 2009, the Board adopted the *Engagement Quality Review* standard. The PCAOB also has issued a number of *Staff Practice Alerts*. Some of these standards and guidance are not yet effective or were recently effective, so their effects have not yet been reflected in audits the PCAOB has inspected. It will take several years for the PCAOB to adequately evaluate the full effects of such improvements.

Rather than the PCAOB setting standards regarding mandatory audit firm rotation, audit committees should, and do, initiate firm rotation as they deem necessary or appropriate. Audit committees need to be very diligent in dialoguing with their auditors regarding the quality of their financial reporting. It is important that auditors and audit committees fully engage in meaningful two-way communication, especially as it relates to areas that are highly subjective in nature. Perhaps the PCAOB could provide training materials to inform audit committees about enhancing their oversight in a way that meaningfully improves auditor objectivity.

The auditing profession needs to take responsibility for improving the exercise of objectivity. Audit firms should consider the sufficiency of formal training provided to their auditors regarding the use of auditor judgment. The complexity of today's accounting and auditing issues, together with the effects of challenging economic times, increase both the frequency and the depth of the use of auditor judgment. Additionally, with the movement toward more principles-based standards and more fair value measurements, exercising good professional judgment will be increasingly important for auditors. These factors indicate that even experienced auditors should consistently receive formal in-depth training about how to make and document good judgments and exercise professional skepticism. Because auditing ultimately is about making judgments, auditors must become better at searching through all evidence, acknowledging that there may be biases in what management provides, and supporting conclusions reached through the use of professional judgment with proper documentation.

Because we believe that our reputation for quality is our most valuable asset, we will continue to provide more formal in-depth training to our auditors regarding the use of auditor judgment. Also, after evaluating the root causes of an audit deficiency, if it is determined that there has been a lack of due care on the part of any of our auditors or if an auditor has failed to exercise his or her professional skepticism, there will be ramifications to the auditor initiated by our Firm. We believe the auditing profession must take responsibility for reprimanding or otherwise disciplining any auditor who exhibits a lack of due care or professional skepticism. Ultimately, an auditor who has lost the ability to be objective should no longer represent the auditing profession. It is up to the profession to uphold our reputation and continue to maintain that trust.

Finally, given that PCAOB audit findings indicate consistent performance amongst CPA firms, we question how rotation will improve the results.

We would be pleased to respond to any questions the Board or its staff may have about these comments. Please direct any questions to Bruce Jorth at 561-682-1623.

Sincerely,

McGladrey & Pullen, LLP

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