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JICPA Comments on the PCAOB Rulemaking Docket Matter No. 37 *Concept Release on Auditor
Independence and Audit Firm Rotation*

The Japanese Institute of Certified Public Accountants (“we”, “our” and “JICPA”) is grateful for the opportunity to comment on the Public Company Accounting Oversight Board (“PCAOB”) Rulemaking Docket Matter No. 37 *Concept Release on Auditor Independence and Audit Firm Rotation* (“Concept Release”). We recognize that the discussion raised in the Concept Release could have significant effect on not only the U.S. audit firms, but also other firms outside the U.S. which involve in their audits of the entities listed in the U.S. Also, as stated in the Concept Release, similar debates have also taken place in other jurisdictions, such as in the European Union. Therefore, although we are a professional accountancy body in the jurisdiction outside the U.S., as one of international partners within the auditing profession in the world, we would like to participate in this debate. Based on our discussions, we provide below our views.

(Comments)

- We agree with the importance of enhancement of the auditor independence, objectivity and professional skepticism. At the same time, we believe that the ultimate goal should be the maintenance and enhancement of the quality of audit, as well as of financial reporting as a whole. Any measurements should not interfere with achievement of this goal.

- We recognize that mandatory audit firm rotation could be one of possible approaches to consider on ways to enhance auditor independence, objectivity and professional skepticism. However, since mandatory audit firm rotation has many drawbacks, quality of audit and of financial reporting would be adversely affected by its implementation.

- We believe that mandatory audit firm rotation has drawbacks such as:

- *Implication for accumulation of the knowledge and experience in the auditors and the audit firms*

The auditors and audit firms could not accumulate the knowledge and experience regarding the audited entity or its certain sector due to mandatory firm rotation. Therefore, there may be increased risks that the auditor cannot identify relevant issues. Recently, the entity's environment and financial reporting have become more complex. Without in-depth knowledge and experience regarding the entity and its business, it is more difficult to detect material misstatements which especially involve complex fraud.

- *Increase in audit cost*

From the perspective of the auditor as well as of the entity, it would increase audit cost including time burden as follows:

- ✧ *Increase in audit cost from the auditors*

- ✓ *Increase in cost relevant to acceptance of new audit engagements*

Mandatory audit firm rotation would increase marketing cost to compete for new clients. Also, there would be an increase in procedures relevant to the changing of the auditors, such as quality control regarding the acceptance of client relationships and audit engagements, as well as those relevant to communication between predecessor and successor auditors.

- ✓ *Increase in cost due to lack of knowledge and experience of the entity*

Due to mandatory audit firm rotation as stated above, the auditor lacks sufficient knowledge and experience regarding the audited entity. Therefore, the auditor needs to perform more procedures to obtain understanding of the entity and its environment. Also, mandatory audit firm rotation would increase a case for the initial audit engagements. In the initial audit engagement, unlike in the case of the continuing audit engagement, the auditor needs to develop an audit plan from scratch. In addition, the auditor tends to establish a more cautious audit plan, since the auditor has limited knowledge of the entity, as compared to one in the continuing audit engagement. These would cause an increase in audit cost.

- ✧ *Increase in audit cost from the entities*

- ✓ *Increase in cost to choose the auditor*

Cost to choose the auditor would increase, since the entity need to select the next auditor periodically, and relevant costs such as research cost would be incurred.

✓ *Cause necessity for additional communication with successor auditor*

Successor auditor has no sufficient in-depth knowledge and experience regarding the audited entity. As a result, the entity needs to explain to the successor auditor regarding the entity and its environment, which includes its business as well as its accounting policies. Since there had been no continuous communication between the entity and the auditor, discussions regarding such matters as accounting treatments may take more time.

➤ *Encourage fierce competition*

In addition to an increase in audit cost from rotation, as stated above, it would also encourage fierce competition for new engagements. This may result in low-balling of audit fee.

➤ *Implication on allocation of the resources and motivation of the audit team and the audit firm*

Since there would be more focus on the works relevant to acceptance of new audit engagements, resources otherwise devoted to improve the audit quality, such as investment for establishment and maintenance of relevant quality control policies and procedures, as well as to develop audit firm methodology, would be reduced. In addition, as the audit clients are periodically and automatically rotated off, the motivation for the audit team and audit firm to improve the audit quality will be decreased.

➤ *Limited choice of auditors for the entity*

Especially in the cases where an entity belongs to a large group, components within the group may obtain various non-audit services and the resulting choice of an auditor for the entity may be significantly limited. Also, in certain sectors only a limited number of the entities requiring highly specialized knowledge, such as in insurance and banking, the choice of auditors would be very limited, and in certain cases, it is possible that there is no auditor which the entity can choose.

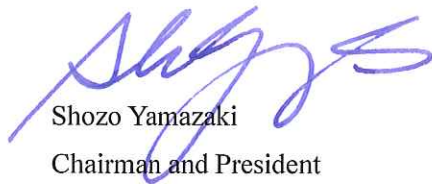
- In addition, we are concerned about the long term implication of above on the audit industry as a whole. Mandatory audit firm rotation would make it difficult for the audit firm personnel to accumulate knowledge and experience specialized in particular industries or areas. Also, since there would be more focus on the work relevant to acceptance of new audit engagements, as the audit clients are periodically and automatically rotated off, the motivation for the audit team and audit firm to improve the audit quality may decrease. Moreover, rotation may result in “low-balling” of audit fees, while increasing audit cost. These various negative effects could

make the audit work less attractive, which may result in lowering of the attractiveness and vibrancy of the audit profession as a whole. We are concerned that this could ultimately lead, in the future, to unintended consequences in the audit profession as a whole, such as inability to attract and foster qualified personnel.

- As stated in the Concept Release, the idea of a regulatory limitation on auditor tenure is not new. The drawbacks stated above have already been pointed out in various debates and academic studies in the past. Also, it is true that there is limited direct relevant empirical data on mandatory rotation, rather than on voluntary rotation. However, there are several jurisdictions in the world which had been, or have been implementing mandatory audit firm rotation, and some of them subsequently abolished the system. The above drawbacks may be reasons for the abolishment and, therefore, we believe the PCAOB should thoroughly survey and analyze the experience of such jurisdictions.
- Also, in considering a possible approach, we believe it is necessary to take into account the globalization of audit. For example, if an entity belongs to large group, components within the group may obtain various non-audit services, and therefore, the choice of the auditor for the entity may be significantly limited. Furthermore, for example, the European Commission published the Green Paper “Audit Policy: Lesson from the Crisis” in October 2010, and the Green Paper includes discussions regarding various measurements such as mandatory audit firm rotation. If a regulator in each jurisdiction implements such radical and uniform measurement respectively, there may be cases where a multinational entity may not have a choice of an auditor.
- In addition, we believe that regulations relevant to the audit should be considered as a whole. We recognize the PCAOB has in progress various auditing standard-setting projects. Each measurement and requirement being considered relevant to audit would, in individually, achieve respective objective. However, from the viewpoint of the audit market as a whole, the regulations may be too burdensome, or the market may not absorb the changes. In such a case, this would lead to unintended consequences that may cause adverse effect on auditing regime as a whole in the longer term. Therefore, in considering proposals to enhance auditor independence, objectivity and professional skepticism, we encourage the PCAOB to consider whether the regulations relevant to audit as a whole would be practicable and at an appropriate level, in conjunction with other measurements relevant to audit being considered.
- The environment surrounding the entity is continuously evolving. Therefore, as stated above,

we agree with the importance of continuous consideration of the enhancement of auditor independence, objectivity and professional skepticism. At the same time, because of the drawbacks stated above, we believe that mandatory audit firm rotation is neither effective nor appropriate measurement. Also, considering that the entity's environment and financial reporting are becoming more complex and that there is more variation in respective circumstances, implementing such a uniform measurement is becoming more difficult situation in the current situation. Therefore, we believe that, in order to enhance the auditor's independence, objectivity and professional skepticism, consideration as to how to enhance the effectiveness of the current system, rather than fundamentally changing it, is the appropriate way forward.

Sincerely yours,



Shozo Yamazaki

Chairman and President

The Japanese Institute of Certified Public Accountants