



DuPont Finance
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December 12, 2011

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

Re: Public Company Accounting Oversight Board Rulemaking Docket Matter No. 37, *Concept Release on Auditor Independence and Audit Firm Rotation*

E. I. du Pont de Nemours and Company ("DuPont") appreciates the opportunity to comment on the Public Company Accounting Oversight Board ("PCAOB" or "the Board") Concept Release on Auditor Independence and Audit Firm Rotation (the "Concept Release") issued on August 16, 2011. DuPont is a world leader in science and innovation across a range of disciplines, including agriculture and industrial biotechnology, chemistry, biology, materials science and manufacturing.

DuPont supports the Board's efforts to enhance auditor independence, objectivity and professionalism. However, we do not believe mandatory audit firm rotation would serve the Board's goals of protecting investors and enhancing audit quality due to the following:

- I. Expected benefits have not been tested and do not outweigh potential risks and costs;
- II. Inconsistent data with regard to investors' demand for mandatory audit firm rotation;
- III. Mandatory audit firm rotation would undermine corporate governance;
- IV. Limited rotation alternatives exist;
- V. Alternatives available to improve audit quality that do not carry the same risks and costs.

I. Expected benefits have not been tested and do not outweigh potential risks and costs

We believe that to consider mandatory audit firm rotation at the current time would result in taking a measure without fully understanding the problem it is expected to solve. The Board notes in the Concept Release that it has concerns with "both the frequency and the type of audit deficiencies it continues to find." However, the Board acknowledges that the inspections are risk-based as opposed to at-random selections and that the Board cannot determine whether inspection findings are a result of a lack of auditor independence and skepticism as opposed to a lack of appropriate technical competence and/or experience. We believe further studies need to be conducted to fully understand the root cause of the inspection findings. Given the increases in financial reporting complexity in recent years, it seems plausible that certain inspection findings may not be the result of auditors exercising the appropriate level of skepticism, but rather reflective of the need for further education surrounding application of these complex principles and/or the need for enhanced oversight.

The Concept Release notes that "by ending a firm's ability to turn each new engagement into a long-term income stream, mandatory firm rotation could fundamentally change the firm's relationship with its audit client and might, as a result, significantly enhance the auditor's ability to serve as an independent gatekeeper." However, we believe there are many positive effects that a long-term relationship can lend to the audit process. The audit-client relationship is

fundamental to the audit process. An audit team with an understanding of a company's business and historical practices will be in a better position to ask the right questions and challenge management on assumptions and estimates as opposed to a new audit team who is focusing on the development of relationships and lines of communication. The November 2003 GAO Report¹ on potential effects of mandatory audit firm rotation summarized survey results from Fortune 1000 public companies and the largest public accounting firms. The survey results indicated that "79 percent of Tier 1 firms and Fortune 1000 public companies believe that changing audit firms increases the risk of an audit failure in the early years of the audit as the new auditor acquires the necessary knowledge of the company's operations, systems, and financial reporting practices and therefore may fail to detect a material financial reporting issue." Academic studies conducted in countries where mandatory audit firm rotation is required (i.e. Italy) suggest that mandatory audit firm rotation has not improved audit quality and audit quality tends to improve over time.²

Further, there is a concern with the impact of mandatory audit firm rotation towards the end of a rotation period. The November 2003 GAO Report indicated that 59% of firms would move talented staff at the end of a tenure to concentrate on attracting and retaining other clients (28% were undecided). We believe there is a risk that audit quality could be impacted by audit firms being distracted with the required investment of time and effort in developing business initiatives to retain the next client.

The Concept Release requests feedback on whether mandatory audit firm rotation will provide a "fresh look" at a company's accounting policies and practices. Since the Sarbanes Oxley Act of 2002 ('Sarbanes Oxley'), there have been several initiatives by the PCAOB as the independent regulator of the auditors of public companies and the public accounting firms themselves to ensure that a "fresh set of eyes" review information to challenge and/or corroborate audit team conclusions. These initiatives include, but are not limited to, mandatory audit partner rotation, involvement of specialists, mandatory national office consultations, internal inspection processes, peer review programs and the engagement quality review partner responsibilities implemented by PCAOB Standard 7, *Engagement Quality Review*. Many of these initiatives have not been in place for a sufficient length of time to provide the Board the ability to observe the full impact of these initiatives.

The Concept Release acknowledges that there would be incremental costs incurred as result of mandatory audit firm rotation. The 2003 GAO report noted that based on surveys conducted with Fortune 1000 Companies and Tier 1 audit firms "...following a change in auditor under mandatory audit firm rotation, the possible additional first year audit-related costs could range from 43 percent to 128 percent higher than the likely recurring audit costs had there been no change in auditor." Audit-related costs include first year audit costs (survey conducted prior to integrated audit), marketing and selection costs and audit support costs.

It is undeniable that any additional costs incurred which would enhance audit quality and result in increased investor confidence would be justifiable. However, as noted earlier, there seems to be minimal evidence to support that a problem with auditor independence and audit skepticism as a

¹ U.S. General Accounting Office, Required Study on the Potential Effects of Mandatory Audit Firm Rotation (November 2003) ("GAO Report")

² See, e.g., M. Cameran, A. Prencipe and M. Trombetta, "Auditor Tenure and Auditor Change: Does Mandatory Auditor Rotation Really Improve Audit Quality?", Working Paper, Bocconi University and IE Business School, 2010 (Bocconi Working Paper); Soo Young Kwon, Youngdeok Lim, and Roger Simnett, "Mandatory Audit Firm Rotation and Audit Quality: Evidence from the Korean Audit Market," 19 November 2010".

result of audit tenure exists and that mandatory audit firm rotation would resolve any issue. We believe other alternatives are available to further improve the independence of the auditor (see section V. of this letter for further discussion).

II. Inconsistent data with regard to investors' demand for mandatory audit firm rotation

It is current practice for public registrants to submit to a shareholder vote, the decision to ratify an audit committee's recommendation to retain the existing auditor. Our experience has shown that investors have approved retention of the existing auditor by a substantial margin. It is our belief that other public registrants' experience is largely consistent with our experience. In fact, as noted in the Ernst & Young comment letter to the Board "...in 2011 proxy season, 92% of Russell 3000 companies placed auditor ratification on the ballot at annual meetings. An average of 98% of votes were cast in favor of the audit committee's choice of auditor, regardless of the length of tenure of the auditor."³

We understand that the Board is responding to the demands of the investment community. However, we believe further studies are necessary to reconcile the feed back the Board has been provided to the actual results of the proxy votes for ratification of auditors that have occurred over the years.

III. Mandatory audit firm rotation would undermine corporate governance

Section 301 of Sarbanes-Oxley mandated that the audit committee be comprised of independent board members with the oversight responsibilities of the independent auditor. Accordingly, the audit committee is charged with overseeing the work of the independent auditor and its relationships with management on behalf of the shareholders of a company. Sarbanes-Oxley establishes the requirement that the audit committee is "directly responsible for the appointment, compensation, and oversight of the work of any registered public accounting firm."⁴ As a result of Sarbanes-Oxley, companies and their boards have undertaken efforts to focus on a heightened sense of corporate responsibility and improvements to the corporate governance process. Mandatory audit firm rotation would impact this current role of the audit committee by undermining this oversight power of the independent auditor. Mandatory audit firm rotation limits the discretion of an audit committee and it takes away from their ability to make the decision to consider a change in the independent auditor. Audit committees would presumably be unlikely to remove an auditor during mandatory tenure due to the costs and efforts that would already be forced upon companies every few years, therefore resulting in decreased motivation around corporate governance during the audit tenure. Due to their vested interest in the underlying company, we believe audit committees are best suited to select and oversee the work of the independent auditor. Any changes to the governance responsibilities of the audit committee should be built on the rules implemented by Sarbanes-Oxley, not change them.

IV. Limited rotation alternatives exist

At the current time, there are limited viable options of audit firms available with the required experience and geographical reach to serve multinational companies. Mandatory audit firm rotation could put constraints against public companies and their abilities to obtain the most

³ Ernst & Young comment letter regarding Docket Matter No.37, Concept Release on Auditor Independence and Audit Firm Rotation dated November 18, 2011

⁴ Sarbanes Oxley Act of 2002, Section 301. Public company audit committees

suitable firm with the requisite industry knowledge and multinational capabilities. In addition to concerns that mandatory audit firm rotation would place on the selection of an audit team, it would also place restrictions on a company's abilities to obtain non-audit services from professional accounting firms. Sarbanes-Oxley limited the number of non-audit services that the independent auditor could provide in order to protect and strengthen auditor independence. With the understanding that rotation would be required, companies would have to consider future rotations and consequences of the engagement of a professional accounting firm for a non-audit service that would be prohibited under independence rules. Mandatory audit firm rotation would limit the choices for both audit and non-audit services and potentially force companies to settle on a firm which may not be the most qualified for the job.

We also have concerns regarding the negative effect that mandatory rotation would pose on the professional accounting firms. We believe the firms may struggle in attracting and retaining top talent as result of mandatory audit firm rotation. There would be uncontrollable challenges around staffing and utilization and firms could face difficulties in attracting professionals to the industry due to the increased potential of recurring geographical relocations. These impacts that mandatory rotation could have on the auditing profession could result in deterioration of audit quality and result in harm to the investor community.

V. Alternatives available to improve audit quality that do not carry the same risks / costs

While we have concerns regarding the benefits of mandatory audit firm rotation, we agree with the Board's initiatives to enhance auditor independence, objectivity and professional skepticism in light of recent economic conditions and increases to financial reporting complexity. Other possible approaches to this initiative are:

- Consider the impact and effectiveness that the objective of recently issued standards will have on audit quality and objectivity such as engagement quality review partner responsibilities implemented by PCAOB Standard 7, *Engagement Quality Review* and the eight new standards issued in August 2010 related to the auditor's assessment of risk in an audit engagement.
- Enhance current auditing standards to provide transparency and clarity regarding acceptable and non-acceptable audit practices. The Board noted in the Concept Release that they continue to find deficiencies in areas that involve critical judgment and estimates. Therefore in the planned project surrounding fair value measurement and other accounting estimates⁵ the Board should consider providing clear expectations regarding audit approach.
- As noted in the Aerospace Industries Association comment letter to the Board⁶, provide direct feedback of inspection results to an audit committee to provide the committee an opportunity to determine appropriate actions to take regarding the inspection findings including consideration of changing audit firms.
- Establish punitive penalties for inspection findings by imposing fines on the audit firm based on the level of severity in which the audit team failed to obtain reasonable assurance about whether the financial statements are free of material misstatement.

⁵ PCAOB Office of the Chief Auditor Standard-Setting Agenda, September 2011

⁶ Aerospace Industries Association comment letter regarding Docket 037: Concept Release on Auditor Independence and Audit Firm Rotation dated October 19, 2011

- Provide further transparency to companies and the investment community regarding PCAOB disciplinary proceedings in order to make the public aware of the current problems the PCAOB is identifying in a timely fashion. We refer to the bill introduced to the Senate on November 18, 2011 that would make public the PCAOB disciplinary proceedings over alleged auditing deficiencies⁷.

In summary, we commend the Board for continuing to explore and challenge the audit profession for opportunities to strengthen audit quality and objectivity. We believe that the actions taken by the Board through the standard setting and inspection processes have improved audit quality resulting in increased confidence by investors and shareholders to use financial information to make informed decisions. However, at this time, we believe there is insufficient evidence to support the benefits of mandatory audit firm rotation and therefore to impose the costs and the efforts upon issuers would be unjustified. As noted above and as stipulated by Sarbanes-Oxley, we believe the independent audit committees are best suited to appoint and oversee the independent auditor on behalf of the shareholders.

Thank you for the opportunity to comment on this Concept Release.

Sincerely,



Barry J. Niziolek
Vice President and Controller
E. I. du Pont de Nemours and Company

⁷ The bill is S.1907 introduced by Senators Jack Reed and Chuck Grassley