



December 13, 2011

Mr. James Doty
Chairman
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, DC 20006-2823

Re: PCAOB Rulemaking Docket No. 37: *Concept Release on Auditor Independence and Audit Firm Rotation*

Dear Mr. Doty:

The Clearing House Association L.L.C. (“The Clearing House”), an association of major commercial banks,¹ appreciates the opportunity to comment on PCAOB Rulemaking Docket No. 37: *Concept Release on Auditor Independence and Audit Firm Rotation* (the “Proposal”).

Executive Summary

The Clearing House supports the efforts of the Public Company Accounting Oversight Board (the “Board”) to enhance the independence, objectivity and professional skepticism of auditors. However, The Clearing House **opposes** a requirement for mandatory audit firm rotation because:

- A company’s Audit Committee is best suited to evaluate whether reappointment of the existing audit firm is appropriate;

¹ Established in 1853, The Clearing House is the oldest banking association and payments company in the United States. It is owned by the world’s largest commercial banks, which collectively employ over 2 million people and hold more than half of all U.S. deposits. The Clearing House Association L.L.C. is a nonpartisan advocacy organization representing—through regulatory comment letters, amicus briefs and white papers—the interests of its owner banks on a variety of systemically important banking issues. Its affiliate, The Clearing House Payments Company L.L.C., provides payment, clearing, and settlement services to its member banks and other financial institutions, clearing almost \$2 trillion daily and representing nearly half of the automated-clearing-house, funds-transfer, and check-image payments made in the U.S. See The Clearing House’s web page at www.theclearinghouse.org.

- The potential downside risks and costs of the Proposal are significant, especially for large companies operating in complex industries, as we believe that mandatory rotation would inhibit the ability of audit firms to develop and maintain specialized industry expertise. We also believe that it would introduce considerable difficulties for many companies in light of existing independence rules governing (i) non-audit services, (ii) financial relationships and (iii) limitations on hiring management and board members,² to the point where many companies will likely find themselves unable to engage any major audit firm due to conflicts with the auditor independence rules;
- There is no clear evidence that mandatory audit firm rotation would enhance auditor independence;
- The Proposal would likely increase the duration and cost of audits for companies operating in complex industries beyond the 20% increase that the GAO predicted in 2003;³ and
- Many recent improvements have been made to the audit process, including (i) mandatory partner rotation, (ii) limitations on non-audit services a firm may provide an audit client, (iii) limitations on when auditors are able to accept employment offers from former clients, (iv) the PCAOB's inspection program and quality remediation process and (v) the AICPA Peer Review Program, all of which we believe have had a positive impact on auditor independence and audit quality.

The Clearing House **recommends** that other alternatives should be considered to further the overall goal of enhancing the quality of audits.

A more detailed discussion of these points follows.

I. The Audit Committee is in the best position to determine whether reappointment of the existing firm is appropriate.

Audit Committees today are vested with significant responsibilities with respect to oversight of the financial reporting process, systems of internal control, the internal audit function and the auditor engagement process. We believe that selecting the auditors, ensuring auditor independence and evaluating the quality of the audit are all fundamental aspects of the Audit Committee's responsibilities, and determining the appropriate tenure of the auditor engagement forms an integral part of this responsibility. In addition, we note that the Audit Committee is made up of independent directors including a financial expert, providing them additional objectivity and experience in evaluating the auditors. Further, the Audit Committee's decision to retain the auditor is approved annually by a company's shareholders, providing a further control over this decision. Mandating a set rotation period would deprive the Audit Committee of discretion, undermine its judgment and otherwise unduly complicate

² Securities and Exchange Commission, Final Rule, Strengthening the Commission's Requirements Regarding Auditor Independence, 68 Fed. Reg. 6006 (February 5, 2003).

³ U.S. General Accounting Office, Required Study on the Potential Effects of Mandatory Audit Firm Rotation (2003) pages 27, 28 and 31, available at <http://www.gao.gov/new.items/d04216.pdf>.

its work. In short, we believe that in light of all of the existing responsibilities of the Audit Committee, as well as the existing controls over these responsibilities, the Audit Committee is in the best position to determine whether reappointment of the external auditors is appropriate.

II. We believe that the potential downside risks and costs of the Proposal are significant.

We believe that rotation would introduce significant disruption and additional costs to companies such that the Proposal could, in fact, undermine, rather than improve, the quality of audits today. As a result, we believe the Proposal would not be in the best interest of a company's shareholders.

In particular, mandatory rotation would create unique challenges for audits of large, complex companies, given the scale of the audits required and the fact that for these types of companies there is a practical limit to the number of audit firms to choose from. Practically speaking, the largest companies have only four audit firms, the "Big Four," from which to choose. Even among these firms, different firms have different capacities and areas of expertise. Financial services firms in particular are complex from both an operational, as well as a technical, accounting perspective, and present particular challenges for audit firms that do not have this type of industry expertise. We are concerned that mandatory rotation would hinder the ability of audit firms to develop and maintain essential industry expertise, to the potential detriment of audit quality. We are further concerned that to develop the necessary industry experience, audit firms might perhaps hire a portion of the staff of the predecessor audit firm, which would then effectively defeat the Board's stated objective of mandatory rotation. Thus, we believe that mandatory auditor rotation would introduce significant difficulties in identifying an audit firm with the necessary skills and expertise to audit a large, complex financial services institution.

Independence rules restricting the kinds of non-audit services a firm may provide its audit client would further limit a company's choice of auditor. For example, a large company might employ one Big Four firm as its auditor and one or more other Big Four firms to provide various non-audit services that its auditor is prohibited from providing. Frequently these non-audit services amount to large, complex multi-year projects. If rotation were required, the company's choice of a new auditor might be limited unless it terminated existing prohibited non-audit services, which it might not be able to do in a timely and cost-efficient manner.

A requirement for mandatory audit rotation also would introduce considerable logistical difficulties with respect to independence rules that limit the financial relationships (*e.g.*, bank accounts, brokerage accounts, credit cards, mortgage loans and other loans) that an auditor may have with a client. This would be especially true for financial institutions. Independence rules governing the hiring of Board members, senior management and other employees also would have to be reconsidered if mandatory auditor rotation were required as such rules would severely complicate recruiting and hiring efforts by both companies and audit firms. In short, it

is hard to see how many of the existing auditor independence rules could co-exist with a requirement for mandatory auditor rotation.

Taking all of the above into consideration, we fear that if a mandatory audit rotation were required, there will be many companies, especially those with large, complex operations, that likely will find themselves unable to retain *any* major audit firm. Accordingly, we believe that it is imperative that such issues be resolved before proceeding further with the Proposal.

III. There is no clear evidence that the Proposal would enhance auditor independence.

While we believe the costs and downside risks of the Proposal are significant, we do not agree that the purported benefits outweigh those costs and risks because there is no clear evidence that mandatory audit firm rotation would enhance auditor independence, objectivity and professional skepticism. The Board has acknowledged that its own inspection data shows no correlation between auditor tenure and number of comments in PCAOB inspection reports. Rather, the findings that are cited in the Proposal are merely anecdotal in nature.⁴ Similarly, the academic research that has examined the relationship between auditor tenure and audit quality cited by the Board fails to support the idea that audit firm rotation would enhance auditor independence. In fact, many of the studies done on this topic seem to point to the opposite conclusion – that audit engagements with shorter tenure are relatively riskier.⁵

As the Board notes, the root causes of audit failures are complex and vary in nature and not all audit deficiencies result from a failure to exercise the required professional skepticism and objectivity.⁶ Audit failures can also reflect a lack of technical competence or experience, staffing pressures or some other problem.⁷ Because there is no clear evidence that audit failures are linked to audit tenure, initiating a mandatory auditor rotation requirement would be akin to conducting a very large-scale experiment with several uncontrolled variables, which would impose significant costs on large, complex corporations, as described below.

IV. Mandatory audit rotation would significantly increase the costs of audits for companies.

We believe that mandatory audit rotation would significantly increase both the duration and required internal and external allocation of resources to audits, thereby increasing the costs of audits for companies, and that increase likely would be higher than the 20% increase that the GAO reported in 2003.⁸ Since that report was issued, there have been significant new

⁴ PCAOB Release No. 2011-006, *PCAOB Rulemaking Docket No. 37: Concept Release on Auditor Independence and Audit Firm Rotation*, (the "Proposal"), August 16, 2011, page 16, available at http://pcaobus.org/Rules/Rulemaking/Docket037/Release_2011-006.pdf.

⁵ Proposal, page 16.

⁶ Proposal, page 6.

⁷ Proposal, page 6.

⁸ U.S. General Accounting Office, *Required Study on the Potential Effects of Mandatory Audit Firm Rotation* (2003) pages 27, 28 and 31, http://pcaobus.org/Rules/Rulemaking/Docket037/Release_2011-006.pdf.

requirements to satisfy Sarbanes-Oxley regulations,⁹ such as the external auditor's requirement to report on the adequacy of a company's internal controls with respect to financial reporting. Requiring a new audit firm to familiarize itself with a company's internal control structure every few years likely would lead to significantly higher audit fees for companies, as well as require significantly higher allocations of internal employee man-hours to audits. In addition, there would be increased costs associated with the frequent duplication of the start-up and learning time necessary for an audit firm to gain familiarity with a company and its operations that is necessary for an effective audit. There also would be additional costs associated with new auditors requiring consents from previous auditors to include prior years' audit opinions in offering documents and other public filings, and other requests to review the workpapers of predecessor auditors. As a result, we believe that the Proposal would result in significant additional, and unnecessary, costs to companies.

V. Recent enhancements to auditor independence requirements should be considered.

We also believe that some of the historical perspectives on rotation cited in the Proposal are no longer relevant in light of some of the significant, and relatively recent, enhancements to auditor independence, many of which were introduced by the Sarbanes-Oxley legislation, including: mandatory rotation of engagement partners, audit firm internal policies on turnover of other senior personnel assigned to an audit, limitations on the kinds of non-audit services a firm may provide to an audit client, limitations on when auditors are able to accept employment offers from former clients, and other recently promulgated and pending changes to the Board's auditing standards and regulatory enhancements to Audit Committee practices.¹⁰ In addition, we believe that the rigor of the PCAOB's inspection program and quality remediation process has led to numerous and significant improvements in firm audit methodologies, processes and related quality control systems. We believe that these significant reforms, as well as the AICPA Peer Review Program,¹¹ have enhanced auditor independence and improved the quality of audits performed. As former SEC Chairman Christopher Cox stated in 2007, "Sarbanes-Oxley helped restore trust in U.S. markets by increasing accountability, speeding up reporting, and *making audits more independent* (emphasis added)."¹² These enhancements may not yet be reflected in the statistics reviewed by the PCAOB.

⁹ Sarbanes-Oxley Rulemaking and Reports, available at <http://www.sec.gov/spotlight/sarbanes-oxley.htm>.

¹⁰ Docket 029 : Improving Transparency Through Disclosure of Engagement Partner and Certain Other Participants in Audits, available at <http://pcaobus.org/Rules/Rulemaking/Pages/Docket029.aspx>; Docket 036 : Proposed Auditing Standard on Auditing Supplemental Information Accompanying Audited Financial Statements and Related Amendments to PCAOB Standards available at <http://pcaobus.org/Rules/Rulemaking/Pages/Docket036.aspx> and Auditing Standards Related to the Auditor's Assessment of and Response to Risk and Related Amendments to PCAOB Standards, 75 Fed. Reg. 59332 (September 27, 2010).

¹¹ AICPA Peer Review Program available at <http://www.aicpa.org/InterestAreas/PeerReview/Resources/PeerReviewProgramManual/2011/Pages/default.aspx>.

¹² Farrell, Greg (2007-07-30), "[USA Today – SOX Law Has Been a Pretty Clean Sweep](#)". USA Today.com.

VI. Other alternatives should be considered by the Board.

We note that while the Proposal focuses exclusively on mandatory rotation of audit firms, the overall goal of the Proposal is to enhance the independence, objectivity and professional skepticism of auditors. We believe that the Board should consider alternatives to mandatory rotation of auditors that would further the achievement of this goal. For example, we understand that there is currently no requirement for an audit firm to share the results of an inspection with the company whose audit is being inspected. Although we believe that firms generally do notify their clients and Audit Committees when an inspection is being performed, they may not always share the results of the inspection. The Board should consider requiring that this be done.


Conclusion

We do not believe that a convincing case has been made that mandatory rotation of audit firms would further protect investors or enhance audit quality. In fact, taking into account the considerable potential costs and disruption this Proposal would introduce, we believe the Proposal could, in fact, undermine the quality of audits. Accordingly, we believe that the Proposal would not be in the best interest of a company's shareholders, and we recommend that the Board not proceed with the Proposal.

* * *

Thank you for considering the comments provided in this letter. If you have any questions or are in need of any further information, please contact me at (212) 613-9883 (email: david.wagner@theclearinghouse.org) or Gail Haas at (212) 612-9233 (email: gail.haas@theclearinghouse.org).

Sincerely yours,



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