

December 13, 2011

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

Submitted via email to comments@pcaobus.org

Re: PCAOB Release No. 2011-006: *Concept Release on Auditor Independence and Audit Firm Rotation*

Dear Office of the Secretary:

On behalf of the 10,000 members of the Virginia Society of CPAs (VSCPA), we have reviewed the *Concept Release on Auditor Independence and Audit Firm Rotation* (the Concept Release) issued by the Public Company Accounting Oversight Board (PCAOB). The VSCPA is a leading professional association dedicated to enhancing the success of all CPAs and their profession by communicating information and vision, promoting professionalism, and advocating members' interests. The VSCPA membership consists of more than 10,000 individual members who actively work in public accounting, private industry, government and education. We appreciate the work the PCAOB has undertaken on this effort and the opportunity to respond to this Concept Release.

The VSCPA does not support the Concept Release's proposal to institute mandatory audit firm rotation at this time. Our opposition to this proposal centers on the following factors:

- There is not sufficient evidence to warrant the costs and risks of adoption.
- The proposal carries possible negative consequences, including a decrease in audit quality.
- Other viable options may better address failures in audit quality and the impairment of auditor independence.

Background

We recognize that the PCAOB's inspections of audit firms registered with the PCAOB continue to identify a number of audit failures. The number and nature of failures have raised concern with the PCAOB and it understandably wishes to take action to address these failures. We also understand that the PCAOB attributes many of these failures to insufficient auditor independence.

While the title of the Concept Release includes reference to the broad topic of addressing auditor independence, the content of the release focuses exclusively on addressing the concerns regarding independence through the adoption of mandatory audit firm rotation. We wish the Concept Release had explored other alternatives for enhancing auditor independence beyond mandatory audit firm rotation. We hope that the PCAOB will solicit input from the public regarding other methods that could be implemented to enhance auditor independence and improve audit quality.

Insufficient Evidence to Support Mandatory Audit Firm Rotation

The main argument in favor of mandatory audit firm rotation seems to be concern that there is an inherent threat to auditor independence if auditors are influenced by their desire to protect their revenue stream from long-term audit clients. However, we do not believe that the Concept Release has presented sufficient evidence that the absence of mandatory audit firm rotation contributes significantly to the audit failures identified by the PCAOB.

We note that the U.S. Government Accountability Office (GAO) conveyed the same concerns after conducting a review in 2003. In the GAO's report, it was noted that further study was required and that the GAO wished to see the result of the PCAOB's inspections before offering its opinion on the

advisability of mandatory audit firm rotation. As stated in the Concept Release, the PCAOB has had difficulty in determining the cause of the audit failures identified during these inspections. In light of this, it seems that the PCAOB should attempt to gain more insight on the root causes of the audit failures identified in their inspections in keeping with GAO's concerns. We recommend that the PCAOB undertake additional efforts to identify the underlying causes of these audit failures before making significant changes such as requiring audit firm rotation.

The Sarbanes-Oxley Act included the requirement for audit engagement partner rotation. We would recommend that the PCAOB compare the number and type of audit failures before and after this requirement, if it has not already done so. We are curious as to whether this provision has increased audit quality. The answer may inform the possible efficacy of the PCAOB's current proposal on audit firm rotation.

Possible Negative Consequences

The Concept Release noted that academic research indicates there is an increase in audit failures in the first year of financial statement audits. This research suggests that mandatory audit firm rotation may, in fact, create more harm than it prevents. If companies are required to obtain new auditors on a regular basis, then the research indicates that audit quality will suffer due to the lack of institutional knowledge and familiarity with new audit clients. Consequently, the PCAOB's proposed course of action would accept the likely risk of decreased audit quality in exchange for the uncertain likelihood of increased audit quality from audit firm rotation.

Additionally, mandatory audit firm rotation could result in the risk of companies "opinion shopping" when solicitations are sought for the company's audit. In audits of federal government agencies, audit firms are often rotated after five years. There have been examples of agencies receiving negative audit findings, obtaining new audit firms in a subsequent year, and receiving clean opinions with no internal control findings from the new audit firm. This may indicate that entities with negative audit findings are prone to "opinion shop" for a firm that will issue a clean opinion. This can occur when audit firms have an opportunity to bid on a potential new audit client. The audit firms have an incentive to bid a low fee for the audit which can give the entity being audited the impression that the audit firm will not conduct a robust audit, making it more likely that a clean opinion will be issued.

In our view, this illustrates the fact that audit firms have an incentive to issue clean opinions with long-term clients, as well as with new clients. As a result, we believe that the remedy for the audit failures discovered by the PCAOB should be sought through measures other than mandatory audit firm rotation.

Further, for large, international concerns that require audit firms with an international presence such as the "Big Four" CPA firms, their auditor choices have been reduced due to industry consolidation. For example if a company uses a Big Four firm for their audit and another for consulting services, then only two firms remain as options for auditor rotation. If one of the remaining two lacks strong experience in the company's industry, then they may feel there is only one choice if required to switch audit firms.

Given the high costs and potential harm to audit quality that would result from mandatory audit firm rotation, it does not seem prudent to make this dramatic change.

Other Options Exist

The Concept Release did not mention the role of the peer review process in addressing this issue. We would like to see enhancements to the peer review process pursued as a possible means to addressing the audit failures identified by the PCAOB. It seems likely that enhancements to this process could be implemented at less cost and disruption to the audit process than requiring mandatory audit firm rotation.

In summary, the VSCPA does not feel that there is sufficient evidence that mandatory audit firm rotation will address the problems identified in the Concept Release to merit its adoption at this time. Because its

implementation will impose significant costs and disruption on companies subject to this requirement, we believe there should be stronger evidence that the measure will be effective in addressing the root causes of the audit failures.

Again, the VSCPA appreciates the opportunity to respond to this Concept Release. Please direct any questions or concerns to VSCPA Government Affairs Director Emily Walker at ewalker@vscpa.com or (804) 612-9428.

Sincerely,

A handwritten signature in black ink, appearing to read "Damon DeSue". The signature is fluid and cursive, with a large initial "D" and a long, sweeping underline.

Damon DeSue, CPA
2011–2012 Chair
Virginia Society of CPAs