Praxity™
GLOBAL ALLIANCE OF INDEPENDENT FIRMS

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December 13, 2011

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street NW
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RE: PCAOB Rulemaking Docket Matter No. 37
Concept Release on Auditor Independence and Audit Firm Rotation

Praxity, AISBL is a global alliance of independent firms. Our membership consists of 72 participating firms in 82 countries, of which eight are headquartered in the United States. Praxity participating firms are chosen to participate in the alliance after a rigorous screening. Our member firms retain their own branding, independence, quality control and financial responsibility. Firms in the alliance share a common desire for quality and excellence.

Our U.S. member firms cover all the major markets across the country and collectively audit over 300 SEC issuers.

Praxity appreciates the opportunity to provide feedback to the Public Company Accounting Oversight Board's Rulemaking Docket Matter No. 37, "Concept Release on Auditor Independence and Audit Firm Rotation." This letter represents the observations of the senior technical leaders from our U.S. member firms, but not necessarily the views of any specific firm, individual, or Praxity governing board member. Based on the nature of the issuers we audit, our views are focused on small to medium sized issuers.

Overall Comments

There is no question that independence, objectivity, and skepticism are critical to an effective independent audit and a key cornerstone for continued confidence in the audit profession. We generally support the PCAOB's continued efforts to examine independence and skepticism. That being said, we believe existing standards and rules of the PCAOB and SEC are sufficient in scope and clarity to support, and enforce, auditor independence and objectivity. The vast majority of public company auditors are committed to conducting themselves with an appropriate level of objectivity and skepticism. Objectivity and skepticism are states of mind. Since the existing standards are clear about the required objectivity and skepticism, it does not appear more or new rules would have any different effect. We believe a more comprehensive study of the root causes of the inspection findings deemed to be caused by a lack of objectivity or skepticism, both at the PCAOB level and firm level, would have a greater chance of identifying how meaningful improvement can be achieved.

For example, while we acknowledge auditor skepticism is a critical component of audit quality, and we acknowledge that maintaining that objectivity and skepticism requires constant attention, we question whether lack of skepticism is the sole, or even primary, factor causing increased inspection comments. Those that have not had first-hand experience with the audit process, either as an auditor or as management of an issuer responsible for the audit, would not likely appreciate the extent to which auditors really do challenge the conclusions reached by the issuers we audit. Even PCAOB inspectors can only surmise the extent to which an accounting or reporting issue is vetted based on the information contained in audit work papers. If those workpapers only describe the issue and conclusion without a detailed journaling of all the considerations in between, it would be difficult to evaluate the auditor's objectivity or skepticism. In fact, we think it is probable that many deficiencies identified by inspectors that are deemed to be attributed to a lack of objectivity or professional skepticism are more likely inadequate documentation of the complete analysis of an issue.[1]

Auditors are required to make hundreds of judgments over the course of an audit about complex matters based on inexact and constantly evolving information, and are expected to do it within a reasonable timeframe. Moreover, increasing complexity in business transactions and accounting standards and the increasing significance of fair value and other measurements that involve inputs subject to significant judgment create a continually expanding and changing landscape in which auditors are challenged to exercise their own judgment. The tools and expertise auditors have in exercising judgment and reaching conclusions develops over time, and procedures employed and judgments reached over time may change as a result of developments in information and processes more so than as a result of a perceived lack of skepticism.

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[1] We understand that a lack of documentation is itself an audit deficiency, and if audit workpapers do not clearly document the work performed, questions remain as to whether that work was, in fact, performed. However, during PCAOB inspections of our member firms, as issues arose and engagement team members were questioned, in many cases it was clear that the workpapers did not document all the work that was done or all the information that was available and considered. Since the implementation of AS 3, *Audit Documentation*, we have worked hard to improve documentation, including documentation of our consideration of dis-confirming evidence, and it will continue to be an area of focus for continued improvement.

The need to consider mandatory audit rotation is in part due to the existing auditor pay model. Many non-auditors that critique our profession believe that as long as the issuer pays fees to the auditor, the auditor will be less than objective in dealing with the issuer. That belief necessarily assumes that our integrity is for sale; that we will ignore our responsibility to the public in order to keep our flow of audit fees. Those of us in the profession understand that the risk of loss from a real audit failure far exceeds the fees we receive. The pay model is not the problem. Remaining objective and skeptical is difficult not because of the pay model, but because we are human. We believe that the role of the independent audit committee is an important counterbalance in evaluating the objectivity of the auditor.

In our opinion mandatory auditor rotation would not meaningfully improve independence, objectivity, and skepticism and would impose substantial cost to both issuers and auditors. We think the risk created by the loss of institutional knowledge when changing auditors significantly exceeds the risk associated with familiarity. Increased costs would come in the form of costs to the audit firms from additional time incurred in a first-year engagement and potential personnel relocation, training and other costs, among others. Issuers would also incur increased internal cost in soliciting and reviewing proposals, interviewing firms, informing the new auditor on their systems, business, and unique or complex accounting and financial reporting issues.

Undoubtedly, one could envision scenarios under which a forced auditor rotation might have resulted in a different conclusion on an accounting or reporting matter. Realistically, however, those fact patterns are few and far between and imposing substantial cost on 100% of the issuer population to compensate for that remote possibility is unwarranted. While we accept our unwavering responsibility for audit quality, it remains appropriate to consider the cost-benefit of any new rule or standard. In this case, we believe the cost far outweighs the benefit.

In addition to the incremental costs, mandatory auditor rotation undermines the role of the issuer's independent audit committee. The Sarbanes-Oxley Act placed the responsibility of hiring, firing and overseeing the external auditor clearly with the audit committee. This has had a positive impact on audit quality as it provides both a mechanism for oversight of the auditors and oversight of management, providing the auditors additional leverage in resolving potential disagreements with management. However, the sophistication and quality of audit committees can vary widely, in particular for smaller issuers. We believe that consideration should be given to identifying ways to work with the SEC to enhance the effectiveness of audit committees, especially audit committees of smaller issuers. Requiring or encouraging audit committee members that can really speak and think accounting would allow the audit committee to more effectively analyze the performance of management and the external auditor. We believe that taking steps to enhance the effectiveness of the audit committee, would be a better course of action toward improving quality than mandatory auditor rotation.

Other Comments

- Mandatory audit firm rotation limits the ability of the audit committee to select the best auditor for the company. In addition to limiting the choice for very large companies, who may be restricted due to tax or advisory relationships or lack of geographic specialization, choice may be limited for smaller issuers as well, whose choices may be limited by the number of audit firms with SEC experience or specialized industry experience in a geographic area. Smaller issuers typically have a smaller pool of qualified auditors available. The largest firms frequently are not interested in handling the smaller accounts. Mandating auditor rotation further limits those choices.
- Initial audit engagements could incur 20% to 40% more audit hours. Mandating a change that creates this additional time puts extraordinary burden on audit firms that could result in reduced audit quality overall.
- Initial audit engagements incur substantial additional time for the issuers too. Most small issuers tend to be staffed very lean - the additional burden on the issuers would also be significant.
- Additional resources would certainly be consumed in the more constant flow of audit proposals. This would include partners responsible for issuer audits, potentially distracting them from their auditor responsibilities.
- We do not agree with the argument that audit quality is negatively impacted by the desire to provide "good client service" in order to retain a client relationship. Good client service is not synonymous with ignoring our responsibilities or allowing a client to have its way. In fact, good client service is making the difficult calls when they need to be made. In the long run both the issuer and the auditor are better off by doing the right thing.

Conclusion

The PCAOB, the SEC and independent audit firms have a common goal of continually improving audit quality and protecting the public interest and we must remain committed to exploring how we can maintain and, where needed, improve auditor independence, objectivity, and professional skepticism. It is our opinion that mandatory auditor rotation is not an effective means to achieve that objective.

We would be pleased to discuss our comments with members of the Board or its staff.

Respectfully submitted,

Kathryn Byrne
North American Chair – Praxity, AISBL