SOCIETY OF CORPORATE SECRETARIES
& GOVERNANCE PROFESSIONALS

via e-mail to: comments@pcaobus.org

December 13, 2011

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

Re: PCAOB Rulemaking Docket Matter No. 37
Concept Release on Auditor Independence and Audit Firm Rotation (the "Concept Release")

Ladies and Gentlemen:

The Society of Corporate Secretaries and Governance Professionals (the "Society") is a professional association, founded in 1946, with over 3,000 members who serve about 2,000 companies. Society members are responsible for supporting the work of corporate boards of directors and their committees and the executive management of their companies regarding corporate governance and disclosure. Our members generally are responsible for their companies' compliance with securities laws and regulations, corporate laws, and stock exchange listing requirements. The majority of Society members are attorneys, although our members also include accountants and other non-attorney governance professionals.

* * * * * * *

We appreciate the opportunity to comment on the Concept Release, published on August 16, 2011 (the "Concept Release" or "Release") and commend the efforts of the PCAOB (the "Board") to consider enhancements to auditor independence and audit quality. However, for the reasons discussed below, we urge the Board not to propose rules mandating auditor rotation.

Mandatory Auditor Rotation Has Been Considered On Several Occasions and Never Adopted

The notion of requiring public companies to periodically rotate their independent audit firms is not new. In fact, the Board notes various instances in which this concept has been considered by both Congress and the Securities and Exchange Commission (the "SEC") over the last 40 years.[1] Each time, mandatory rotation has been rejected, principally due to the increased costs and risks caused by rotation coupled with the lack of any significant benefit to investors.[2] In 1994, an

[1] Concept Release, at p. 3.
[2] See, *e.g.,* The Commission on Auditors' Responsibilities: *Report, Conclusions, and Recommendations* (1978), and SEC Office of the Chief Accountant, *Staff Report on Auditor Independence* (1994).

SEC study concluded that "the [profession's] requirement for a periodic change in the engagement partner in charge of the audit, especially when coupled with the requirement for second partner reviews, provides a sufficient opportunity for bringing a fresh viewpoint to the audit without creating the significant costs and risks associated with changing accounting firms."[3]

Congress considered mandatory rotation when it made sweeping reforms in the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley"). However, at that time, instead of requiring rotation, Sarbanes-Oxley commissioned a study and review of the potential effects of requiring mandatory rotation. The United States General Accounting Office's ("GAO") report concluded:

> We believe that mandatory audit firm rotation may not be the most efficient way to enhance auditor independence and audit quality, considering the costs of changing the auditor of record and the loss of auditor knowledge that is not carried forward to the new auditor. We also believe that the potential benefits of mandatory audit firm rotation are harder to predict and quantify while we are fairly certain there will be additional costs. In that respect, mandatory audit firm rotation is not a panacea that totally removes pressures on the auditor in appropriately resolving financial reporting issues that may materially affect the public companies' financial statements. Those pressures are likely to continue even if the term of the auditor is limited under any mandatory rotation process.[4]

Instead of mandating rotation, Sarbanes-Oxley required the rotation of the lead audit partner every five years and other audit firm employees with significant involvement in the audit every seven years.[5] The Society believes that these existing requirements, *particularly partner rotation*, adequately address the concerns of professional skepticism and ongoing objectivity. Essentially, the rotation of audit firm personnel gives the audit a fresh look, without disrupting the continuity of audit firm service.

In addition, the Release admits that there is no evidence of pervasive audit failures caused by long-term tenure or any other factor to which mandatory auditor rotation would be responsive. The lack of such evidence is particularly noteworthy given the PCAOB's access to significant information from its inspection process regarding audit failures. If and when there is evidence of a pervasive problem to which mandatory audit firm rotation would be a remedy, only then should such a drastic change be considered.

---

[3] Concept Release, at p. 11, citing SEC, Office of the Chief Accountant, Staff Report on Auditor Independence 1 (1994).

[4] United States General Accounting Office, *Public Accounting Firms: Required Study on the Potential Effects of Mandatory Audit Firm Rotation* (2003), p. 50 ("GAO Study").

[5] Sarbanes-Oxley Act of 2002, Section 301.

As Contemplated by Sarbanes-Oxley, Audit Committees Should Have Sole Responsibility for Auditor Selection

Perhaps the most significant auditor independence and audit quality enhancement adopted pursuant to Sarbanes-Oxley was Rule 10A-3 under the Securities Exchange Act, which made the appointment, compensation and oversight of independent auditors the sole responsibility of a company's audit committee.[6] In adopting this Rule in 2003, the SEC noted that "[o]ne of the audit committee's primary functions is to enhance the independence of the audit function, thereby furthering the objectivity of financial reporting… One way to help promote auditor independence, then, is for the auditor to be hired, evaluated and, if necessary, terminated by the audit committee. This would help to align the auditor's interests with those of shareholders."[7] The SEC also noted that "overall commenters…supported that audit committees should be given flexibility regarding the execution of these responsibilities without rigid rules."[8] We believe that these considerations remain valid and that, as a result, the audit committee should continue to have sole responsibility for selecting a company's audit firm, and the audit committee is best able to judge if the audit firm is bringing the right level of technical competence, objectivity and professional skepticism to its work.

This sentiment was echoed by the GAO. Its 2003 report stating that mandatory audit firm rotation may not be the most efficient way to enhance auditor independence and audit quality also noted that: "We also believe that currently audit committees, with their increased responsibilities under the Sarbanes-Oxley Act, can play a very important role in enhancing auditor independence and audit quality."[9] Under mandatory rotation, the committee would be required to select another firm, even if the committee believed that another firm may not discharge its responsibilities as effectively and independently as the current firm.

Sarbanes-Oxley's numerous audit committee requirements were furthered by subsequent rules of self regulatory organizations that strengthened the committee's responsibilities for oversight of the audit firm, including requirements entailing heightened levels of independence and expertise of audit committee members. Under New York Stock Exchange ("NYSE") rules, an audit committee must consist solely of independent directors, each of whom is "financially literate" with at least one member who has accounting or financial management expertise.[10] Additionally, NYSE rules require that the audit committee at least annually obtain and review a report from the audit firm that describes the firm's internal quality control procedures and all relationships between the independent auditor and the listed company.[11] The audit committee must also meet separately and periodically with the independent auditors and set clear hiring

---

[6] *Id.*

[7] SEC Release No. 34-47654, "Standards Relating to Listed Company Audit Committees," April 9, 2003, *available at* http://www.sec.gov/rules/final/33-8220.htm.

[8] *Id.,*

[9] GAO Study, at p. 51.

[10] New York Stock Exchange Listed Company Manual, Section 303A.07.

[11] *Id.*

policies for employees or former employees of the independent auditors.[12] These and other safeguards strengthen the audit committee's oversight of audit firms, and requiring audit firm rotation would undermine the critical role played a company's audit committee in ensuring the independence and objectivity of a company's audit firm as well as interfering with this body of rulemaking developed by the SEC and self-regulatory organizations.

Public company directors have fiduciary duties that require a high degree of diligence in gathering and considering the information necessary to make informed decisions, including those in selecting a company's independent auditor. In discharging these responsibilities, there may be many valid reasons for an audit committee to determine that rotation to a new audit firm is not in the best interests of its company at a particular point in time. Therefore, mandatory rotation would unnecessarily impinge on the audit committee's independent decision-making and implement a one-size-fits-all approach over the informed business judgment of a company's audit committee based on relevant facts and circumstances.

In view of the above considerations, we believe that the discretion to change a company's audit firm should continue to rest with the audit committee rather than being based upon an arbitrary schedule.

The Costs of Mandatory Rotation Clearly Outweigh Any Benefits

The Society believes that a change as significant as mandatory audit firm rotation must be based on clear objective data showing that mandatory audit firm rotation (i) is required to address evidence of a link between audit firm failure and long-term tenure and (ii) will consistently result in measurably improved audit quality that justifies the projected increase in direct, indirect, and ancillary costs. Past studies have never yielded definitive proof that rotation would achieve the PCAOB's stated aims of enhancing auditor independence in mental attitude, objectivity or professional skepticism or otherwise improving audit quality. In contrast, as detailed below, there is evidence of increased risk of audit failure and reduced audit quality from auditor rotation. Therefore, we urge the Board not to propose mandatory audit firm rotation rules until there is conclusive evidence of benefits to investors that clearly outweigh the significant regulatory and other costs to issuers.

The costs underlying a rotation requirement for both audit firms and public companies exist at the various stages of the process: the search for and selection of the new audit firm, the costs of changing firms and finally the costs of rotating the audit firms after a certain amount of time. Based on a survey of our members and discussion with member companies that have changed their audit firms, the direct, indirect and ancillary costs associated with mandatory auditor rotation would be considerable. Our survey revealed that over 70% of those companies that could estimate additional costs resulting from mandatory rotation believe that costs in the initial year would increase by at least 20%.

---

[12] *Id*.

Selection of New Audit Firm. Each time an audit firm rotation occurs, the company's audit committee, management and employees in its finance, legal, tax, accounting, and internal audit organizations, across all the jurisdictions in which the company operates, must invest significant amounts of time and money to ensure selection of an appropriate new audit firm. The complex process in evaluating a potential new audit firm includes consideration of numerous factors, including the firm's reputation; the firm's knowledge and experience in the company's current and prospective industries and lines of business; the proposed new lead partner's overall business acumen, knowledge and experience in these industries and businesses; the depth of expertise, experience and knowledge of the prospective engagement team; potential conflicts of interest or independence issues with the Board; the scope of the audit firm's international network in the countries and regions in which the company operates, and the firm's ability to provide quality services across those countries and regions; the firm's quality control procedures; findings from recent firm inspections, peer reviews or other oversight reviews; and whether the firm will be able to meet the auditor independence requirements. The thoughtful consideration of each of these factors in support of the important decision on the best audit firm for a company at a given time would likely necessitate thousands of hours of work and analysis and concomitant expenditures.

To illustrate, one of our members, a large global company that voluntarily rotated its audit firm within the past ten years, estimated that the time expended from the start of the request for proposal process through retaining its new audit firm entailed approximately 100 hours of audit committee time, 500-600 hours of senior management time and between 2,000-3,000 hours of finance, legal, tax, accounting, and internal audit employees' time, in addition to the associated administrative and productivity costs. The effort involved included determining the proper selection process, providing due diligence materials to competing firms, evaluating the factors described above to assess the global capabilities, expertise, strengths and weaknesses of potential successor audit firms, as well as the lead manager and senior engagement team, applying the selection criteria to choose a successor firm, and identifying and effectuating all the necessary steps to ensure that the new firm was independent, including winding down and moving ineligible services provided by the successor firm to new service providers. It would inefficient to require thousands of company hours every five or ten years to assess an audit firm change, especially when such a change may not be needed or be in the best interests of a company or its shareholders.

Transition to New Audit Firm. Once an audit firm has been retained, a significant amount of company management time and attention is required to provide the successor firm with the information needed to plan its audits and to support the new firm while it gains familiarity with the company; its history, businesses, operations and facilities; its accounting systems and records; its accounting policies and methodologies; its internal control systems and processes; its information technology systems and applications; and other necessary systems, processes and personnel. In addition, a change in audit firm requires management to respond to an increased volume of audit firm staff requests, including requests for documentation that supports accounting positions that may have been in place for a number of years. A company's audit committee must maintain an appropriate level of oversight throughout the entire process. The

global member company referenced above estimated that the support required to orient the new firm and ensure a successful transition during the first year of its engagement encompassed approximately 20% of the work time hours of over 100 people throughout the organization.

In addition, the disruptive effect of mandatory auditor rotation on a company's ongoing operations and transactions should not be minimized. For example, if a company were seeking to complete a major acquisition or divestiture, or a significant financing, the transaction might need to be suspended until the new audit firm could study the transaction from the standpoints of accounting and financial reporting, among others. In certain cases – for example, if a company faced a serious cash shortfall, such a suspension could be materially detrimental to the company and, possibly, its survival. Even routine financings and other transactions could be jeopardized; at a minimum, they would become more costly and time-consuming, such as when a previous audit firm has to complete subsequent reviews before being able to execute a required consent in connection with a filing under the Securities Act of 1933.

The Society believes that mandatory auditor rotation will lead to both increased audit costs as well as increased costs for audit-related services. This is supported by the GAO's 2003 Report, which found that nearly all of the larger audit firms surveyed estimated that initial year audit costs would be more than 20% higher than subsequent years' costs; the responses from the Fortune 1000 public companies were similar. As discussed above, our members' estimates of increased first year costs are comparable.

The GAO survey also addressed the overall costs to both audit firms and Fortune 1000 public companies, including estimated indirect and ancillary costs, consisting of marketing costs (i.e., the costs incurred by the audit firm related to their efforts to acquire or retain financial statement audit clients), selection costs (i.e., the internal costs incurred by a public company in selecting a new public accounting firm as the public company's auditor of record), and support costs (i.e., the internal costs incurred by a public company in supporting the public accounting firm's efforts to understand the public company's operations, systems, and financial reporting practices). The GAO estimated additional first year audit-related costs (inclusive of the foregoing costs as well as audit costs) would be 43% to 128% (and, on a weighted average basis, 102%) higher than the likely recurring audit costs had there been no change in the audit firm.

The Society members' experience is that audits in the initial years after a change in audit firm are less efficient and more expensive. Audit fees are generally based on the expected hours needed to complete the scope of work set out in the audit plan. Initial years' audits and audit related services take more time and are inherently less efficient, and thereby more expensive, than subsequent years' services. Among other matters, the new audit firm must review the predecessor auditors' documentation, obtain a complete understanding of historically significant events, and gain an understanding of the company's business model, control environment and reporting practices, in order to appropriately determine the scope and conduct of its audit. It takes time before an auditor can appropriately coordinate with a company's internal audit staff and ascertain the appropriate staffing and conduct of its audit, which impacts both the direct costs of the audit and the quality of the audit. Appropriate reliance on internal audit staff and

knowledge gained from its prior work enable an outside auditor to focus its audit personnel on the higher risk areas of an audit.

Audit firms have historically absorbed some of the expenses involved in servicing new clients as, for example, shadowing an incumbent firm during the incumbent's firm last audit. With mandatory rotation, audit firms could be expected to pass on these costs to clients as companies change auditors more frequently. For companies that use the same audit firm for both audit and tax services, a mandatory rotation would indirectly increase the cost of tax compliance as well, either because the audit team would not be working in tandem with the tax service team, or because the company would also have to rotate its tax professionals at the time it rotated its auditors.

Rotation Would Negatively Affect Audit Quality and Would Have Minimal Benefits, if Any

While the Release suggests several potential benefits associated with rotation, the Society believes that mandatory auditor rotation will introduce significant issues that would likely contribute to an actual *decrease* in audit quality.

Contrary to the Concept Release's position that mandatory auditor firm rotation would enhance auditor quality, we believe that it will have the opposite effect, actually harming audit quality. Evidence in the Concept Release indicates that audit quality in the first years of an engagement tends to be lower, and therefore could lead to a greater risk of audit failure.[13] Because the start-up requirements for a new audit, such as gaining familiarity with the client's particular practices, are significant for an incoming auditor, the ability to conduct the audit with the degree of diligence and thoroughness possible in later years is lessened.[14] With a mandatory rotation rule in place, companies will spend more time in a short-tenure audit situation, and overall audit quality will be negatively impacted. More than 85% of our members surveyed were "very concerned" about the loss of its audit firm's institutional knowledge if required to switch auditors.

Finally, incoming auditors, unfamiliar with the details of a new client's business, will be less likely to identify fraud or deception on the part of a company's management and employees. The accumulated experience of a longer audit tenure helps a firm better spot and account for these issues. Studies conducted in 1987, 1999 and 2010 revealed numerous audit failures involving companies that recently changed auditors – and the 2010 study concluded that the topic needed to be studied more.[15]

The evidence from academic studies, and even the PCAOB's own data, show that short audit tenure leads to higher incidences of audit failure. Nevertheless, the Concept Release attempts to

[13] *See, e.g.,* Concept Release, at p. 16.
[14] Benito Arruñada, *Mandatory Rotation of Company Auditors: A Critical Examination*, 17 Int'l. R. of Law & Econ. 32 et seq, 33 (1997).
[15] Concept Release, at p. 16.

cast doubt on this empirical evidence by suggesting that the samples are self-selected – that in a voluntary rotation system, auditor rotations (and shorter tenures) only occur where a problem already exists.[16] However, several of these academic studies found audit quality decreased with shorter tenure under the mandatory audit firm rotation rule implemented in Italy.[17]

It seems likely that audit firm rotation will lead to a merry-go-round in provision of audit-related services, as there are limits on non-audit work that can go to the audit firm. This has various ramifications, among them that the outgoing audit firm is likely to be among those seeking to acquire newly-available non-audit engagements previously fulfilled by the incoming audit firm. The same concerns presented by advocates of mandatory rotation – reduced professional independence – will manifest here, as there is a risk that an incumbent audit firm may seek to placate management in order to obtain non-audit business upon rotation.

Given the inability to date to demonstrate the link between mandatory auditor rotation and enhanced auditor independence, objectivity and professional skepticism (and thus, presumably, increased audit quality), costs of the magnitude discussed above clearly are not justifiable, particularly in the context of information and projections indicating that such a requirement may in fact result in reduced audit quality in the earlier years of an engagement.[18]

The Concept Release outlines two commonly-argued "fresh look"-related benefits, but does not present any empirical evidence that these benefits actually exist. Because clients utilize different accounting methods depending on industry sector and company preferences, an incoming auditor will need to become familiar with the client company's individual practices and control structure. Even among similar or identical accounting procedures, an auditor must gain familiarity with the particular business and internal operations of the client, and must rehash the solutions developed by the predecessor.[19]

Suggested remedies for some of the problems presented by mandatory rotation would exacerbate other detriments of the regime. For example, mandatory auditor rotation is already anti-competitive because it decreases the opportunity costs of cartel-like behavior and reduces the incentives for audit innovation.[20] Reduced quality in initial years of audit engagements could be mitigated by mandatory standardization of audit practices and techniques between audit firms and clients. However, this would exacerbate the anti-competitive effects of mandatory auditor rotation by either preventing innovation entirely, or speeding up the transfer of innovation from

---

[16] *Id.*

[17] M. Cameran, A. Prencipe, and M. Trombetta, *Auditor Tenure and Auditor Change: Does Mandatory Rotation Really Improve Audit Quality?*, Proceedings of the Annual Meeting and Conference on Teaching and Learning in Accounting, New York 1-61, at p. 3 (2008)

[18] Cameran, at 19-20. Italy's mandatory rotation rule required 9-year tenures.

[19] Arruñada, at p. 31.

[20] In an academic model of a 6-firm market, with individual market shares ranging from 5% to 40%, a mandatory rotation rule led to a convergence and stabilization of market share to within a few points of 15% for every firm. Arruñada, at 42.

the innovator to the rest of the industry, resulting in a disincentive to make such improvements and thereby harming audit quality.[21]

When mandatory auditor rotation forces an audit firm to lose an engagement for which it has developed a specialized audit unit, it will not have the convenience of simply shifting those specialized resources to another, similarly-specialized project. While this effect may be ameliorated in a larger market, it will be magnified in smaller markets in less densely-populated areas.

Finally, as discussed above, the benefit of a fresh look is already accomplished by the mandatory rotation of key personnel in the audit. The thoughtful rules already in place require different audit firm employees to work on an audit while maintaining the key infrastructure already in place from the audit firm as a whole.

The PCAOB's Inspection and Enforcement Powers are Sufficient to Ensure Professional Skepticism

There is no foolproof method – even including mandatory audit firm rotation – for ensuring that professional skepticism is maintained throughout the life of an audit firm's tenure. However, the Society believes that the authority that the PCAOB already possesses is sufficient. This includes the authority to (i) regulate audit firms, (ii) publicize a firm's audit failures and (iii) assess penalties (both financial and professional) on auditors they judge to be lacking in professional skepticism. These tools provide an effective arsenal to address issues with the firms through monetary penalties, professional penalties and by publicity of failures that would adversely impact their customer base and, ultimately, an audit firm's ability to retain clients. In this regard, we believe that the PCAOB is in a unique position to use its "bully pulpit" to speak out on the need for auditor skepticism and thereby heighten sensitivity to the topic.

On the other hand, mandatory rotation of external auditors would be an ineffective means of addressing the risk of inadequate professional skepticism, primarily because it fails to consider that professional skepticism is a skill the auditor employs, and instead confuses it with the normal questioning that takes place as a new auditor tries to understand a new client. Professional skepticism is most effectively used by the auditor when they have a full understanding of the facts and circumstances related to their clients' businesses. Mandatory rotation of external auditors will not cure this purported problem.

Mandatory Audit Firm Rotation Would Leave Public Companies with Few Experienced and Eligible Audit Firms

Many public companies—large multinational companies in particular—have very limited choices for audit firms. In fact, many of these public companies can, as a practical matter, only use one of the four large audit firms known as the "big four" to provide audit services.[22]

---

[21] Arruñada, at p. 37.

The "big four" audit firms are unique in their scale and scope, having offices located around the world with thousands of partners and tens of thousands of professional employees who have a global perspective along with in-depth knowledge of local, state and U.S. issues. In addition, there is also an expectation in the capital markets and among investors generally that large U.S. public companies will use one of the "big four" audit firms. As the PCAOB acknowledges in the Concept Release, even among the "big four" audit firms, a company's choice may be further limited because different audit firms have various capacities in different parts of the U.S. and world with differing areas of expertise. And Society members consider these factors critical in considering the selection and retention of an audit firm. In fact, nearly 90% of our members surveyed concluded that its company's audit committee evaluates audit firms based on industry knowledge or international scope and considered these items "very important" in the selection of the audit firm. For instance, a company may need an audit firm with expertise in a particular industry or geographic area, and even the largest audit firms do not necessarily have the requisite specialized knowledge in every location in the world or even in the U.S. It is also not clear whether the "big four" audit firms or the smaller audit firms would be able or willing to devote the necessary resources to build expertise in new geographic locations or in new industries.

Further complicating this issue are other auditor independence standards that would often preclude at least one firm from being selected as the independent audit firm. For example, if an immediate family member of a company's director is an employed by one of the big accounting firms, the NYSE's independence rules may preclude that company from engaging the audit firm during the entire director's tenure on a company's board.[23]

Additionally, independent auditors are prohibited from performing certain non-audit services, such as valuation work for their audit clients, and therefore most large public companies engage one or more of the remaining three of the "big four" audit firms to perform these non-audit services. Our survey revealed that over 83% of companies used at least one additional "big four" firm for non-audit services and a majority of companies utilized at least two additional "big four" firms. Over 85% of our members indicated that mandatory audit firm rotation would limit the company's ability to use other audit firms to provide non-audit services. If such companies wished to retain a firm within the "big four" and avoid the risk of auditor independence problems, they would be required (i) to refrain from using at least one of the remaining three audit firms for non-audit services and (ii) if they are currently using each of the remaining three audit firms to provide non-audit services, to identify and attempt to unwind all of the contracts for the non-audit services with at least one of such firms before the change in auditors. This would be difficult, risky and cumbersome. The process could take one or more years to implement; if one of these firms is implementing a significant financial system for a company, which can take more than a year to accomplish, that audit firm would not be independent until that system has been implemented and is subject to audit by another audit firm. It is clear that this is a major issue for a significant number of our members and a mandatory audit rotation rule

---

[22] See GAO Study, "Table 1: Audit Committee Chairs' Reasons for Limiting Consideration to Only Big 4 Firms."
[23] See New York Stock Exchange Listed Company Manual, Section 303A.02.

would disrupt many of the engagements and relationships that companies currently have with audit firms.

In addition, many large public companies also engage one or more of the remaining three of the "big four" audit firms for tax compliance and consulting work, even though these are not prohibited services under Sarbanes-Oxley, the Exchange Act or applicable accounting standards. These companies believe that there are strong governance reasons for engaging a firm that is not their auditor to perform these services.

The issue of engagement timing further complicates mandatory audit firm rotation, as the length of the typical audit engagement also poses limitations on a company's choice of audit firms. An audit engagement generally runs through the filing of the company's Annual Report on Form 10-K. For example, the engagement of the auditor for a company with a fiscal year that runs from January 1 through December 31 would customarily last until the following February or March, but the engagement period for the successor auditor would start on January 1. Thus, there would be an overlap period during which two of the "big four" audit firms would be engaged as the company's independent auditors, thereby further limiting the company's options for providers of non-audit services.

As a consequence of all of these limitations, if required to rotate, an audit committee will be significantly restricted in its selection of a new audit firm. This is certainly not ideal from a governance perspective and may result in higher prices due to the lack of meaningful choices. Alternatively, companies in this position could opt to engage another audit firm that is not in the "big four", but such firms may not have the ideal qualifications or be acceptable to the capital markets or investors. Given all of these limitations, the Board should not propose mandatory audit firm rotation rules.

Mandatory Auditor Rotation would Impose a Disparate Burden on Small- and Mid-Cap Public Companies

Finally, the Society believes that mandatory audit firm rotation would pose a disparate burden on small- and mid-cap public companies. Generally, these additional burdens would manifest themselves by either straining already resource-limited accounting and legal staffs of these companies and/or by decreasing the attention an auditor would pay toward these companies.

For smaller companies, having to assist in the "ramp up" learning period every five or ten years (or other mandated period) may well cause an a bigger hardship than for larger companies. For many small- and mid-cap public companies, the audit engagement team interacts primarily with the Chief Financial Officer, Controller, Director of Financial Reporting (if there is one), and the General Counsel (again, if there is one). While learning a smaller company's business, industry, and accounting systems and processes may be less complex than at a larger issuer, small- and mid-cap public companies have significantly less resources to devote to educating a new audit team every few years. As a result, either the auditor will not be as "up to speed" as it could be or

the financial and legal staff of the issuer will not have as much time in fulfilling their own responsibilities with regard to the audit. In either case, a higher risk of audit failure is the result.

While strained resources are a very significant risk, the greater risk may be the likelihood that auditors will decrease their focus on small- and mid-cap public companies. The Society is concerned that the smaller fees necessarily charged for smaller company audits coupled with a limited client retention period might cause the "big four" firms to avoid bidding on audit engagements for small- and mid-cap companies, limiting the pool of auditors available to these companies.

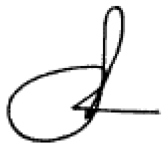
We believe that mandatory auditor rotation will lead to decreased attention and focus of audit firms, higher audit fees than exist today, but not high enough to support a large pool of auditor choices for small- and mid-cap public companies.

* * * * * * *

For all of the reasons set forth in this letter, we urge the Board not to propose any rules that would mandate the periodic rotating of audit firms by public companies. We appreciate this opportunity to share our views with you, and would be happy to provide you with further information to the extent you would find it useful.

Respectfully submitted,

Society of Corporate Secretaries and Governance Professionals



By: Robert B. Lamm
Chair, Securities Law Committee

cc: James R. Doty
Lewis H. Ferguson
Daniel L. Goelzer
Jay D. Hanson
Steven B. Harris