R.G. Associates, Inc.
Investment Research/ Investment Management
201 N. Charles Street, Suite 806
Baltimore, MD 21201
Jack T. Ciesielski, CPA, CFA
President
Phone: (443)977-4370
Fax: (410)783-2955

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

RE: PCAOB No. 2011-006, Rulemaking Docket No. 37 – Concept Release on Auditor Independence and Audit Firm Rotation

Mssrs. Doty, Ferguson, Goelzer, Hanson, and Harris:

I commend the Board for its boldness in raising the issue of requiring mandatory auditor rotation. More importantly, I also support the Board in its broader quest to strengthen the principal/agent bond between investors and auditors, which is solidly evidenced in this proposal and was equally evidenced in the Board's earlier proposal for improving the auditor's report.

While I remain enthused about that idea, I do not support the auditor rotation proposal with anything approaching the same degree of enthusiasm. I agree that the principal/agent bond between investors and auditors needs to be amplified, but I disagree that requiring the rotation of auditors every few years is the best way to strengthen it. Put simply, this change would not be the bold action required for reaching the goal of getting auditors' interests aligned with shareholders' interests.

To achieve that end, the Board needs to eliminate the principal/agent relationship between management audit fee payers and their auditors. The Board may likely expend a great deal of its political capital in shepherding the auditor rotation project through completion, yet it is fraught with attributes that do not ensure it will achieve the real goal of increasing auditor independence. The obvious problems are that it will create disruption and inefficiencies. Yet at its core, auditor rotation simply does not resolve the real issue: auditors can't be completely independent of management as long as they are paid by management. A requirement to change auditors every few years is a mere tinkering with the existing model, because it leaves intact the illogical principal/agent relationship between company and auditor.

This proposal will most likely meet resistance from auditors and preparers because it will, in all probability, increase the cost of an audit should it become an actual PCAOB rule. The following table provides facts that should raise some questions about fees in the auditing profession in the United States that perhaps should be addressed instead of the auditor rotation question. The table presents the total fees spent for auditing and audit related services by 459 members of the S&P 500 from 2002 until 2010. (To preserve trends, 41 companies were excluded because they did not have complete information for the entire period under consideration.)

Audit and Related Fees Since the Sarbanes-Oxley Act of 2002

(in $millions)	**2010**	**2009**	**2008**	**2007**	**2006**	**2005**	**2004**	**2003**	**2002**
PricewaterhouseCoopers	$1,654	$1,661	$1,586	$1,546	$1,507	$1,478	$1,498	$1,000	$802
Ernst & Young	959	939	972	937	903	797	750	552	509
Deloitte & Touche	901	891	950	1,007	963	881	769	493	441
KPMG Peat Marwick	741	737	756	719	709	661	609	408	316
BDO Seidman	7	7	8	7	5	5	9	9	1
Grant Thornton	--	--	--	--	--	--	1	1	1
Arthur Andersen	--	--	--	--	--	--	--	--	2
	$4,262	$4,235	$4,272	$4,216	$4,087	$3,822	$3,636	$2,463	$2,072

Source: Most recent company proxies, through DirectEdgar database.

Notice that audit fees have more than doubled since 2002. After 2002, auditors were required to make examinations of internal controls and to render opinions on those internal controls. It was only natural that audit fees would increase. In fact, the doubling of audit fees mostly occurred between 2002 and 2006 - and they've remained stagnant ever since. This is odd, for a number of reasons.

First, the overall environment became much more risky in the period from 2007 through 2010. It's puzzling to observe a *decrease* in audit fees during an economic period in which one would expect *more* audit work to be performed- and consequently, one would expect higher fees if more work is being performed. It's fair to wonder if auditors were facing tough negotiations on fees with their clients during this period of economic duress. If that's the case, however, it suggests the very condition that needs to be fixed: the tough-minded independence of auditors could be undermined by their dependence on the client for their fee.

Second, the lack of participants in the auditing field suggests that the firms operate in an oligopoly. In terms of possessing the capability to audit large multinational firms, there are only four significant players remaining. One might expect that audit fees would be more inflexible. There's no assurance that the existence of an oligopoly would result in monopolistic pricing - but the experience of the last four years suggests that there may be more price competition than one might expect. Alternatively, auditors may be displaying a significant amount of compassion for their clients who were hard pressed during the years of the financial crisis. If that's so, there's a disconnection between whom the auditors are serving and whom they should be serving – namely, the investors.

Third, there's no accounting for the effect of management consulting practices on the bottom lines of the auditors. It's possible that auditors, which are part of multidisciplinary professional firms, may have been kinder and gentler in terms of the fees charged to their clients while revenue shortfalls were made up by their counterparts in the management consulting practices. That's perhaps the most benevolent explanation for the flat audit fees, but it raises other questions. For instance, do the auditing practices of multidisciplinary firms attract and retain the most technically proficient personnel if there's a more glamorous, less adversarial career alternative available to them within the same firm? Long ago, the SEC resolved the issue of whether or not auditors may perform consulting services for their audit clients. The question of these services on auditor *independence* has been resolved, but the effect of consulting services on a firm's *focus* remains. A widely held view is that firms do better when they focus only on what they do best - when they find a core competency and stick to it. That's the thinking behind many corporate spinoffs and breakups of conglomerates. In fact, many firms are rewarded in the stock market when they renew their focus for streamlining their portfolio of operations. One wonders if audit-only firms would do a more thorough job than the audit firms which are part of much larger firms.

The information in the above table was marshaled in order to gauge how much flexibility there might be in audit fees should rotation become mandatory – at minimum, to gauge how much inflation might appear reasonable in historical terms. Yet the fee history raises puzzling questions that go beyond the issue of whether cost inefficiencies introduced by auditor rotation would be acceptable to investors, and auditor rotation does not supply the answers to these puzzles. There are problems with the structure of the auditing profession which cannot be resolved by trying to improve auditor independence through auditor rotation. Rather than deliberating over mandatory auditor rotation, the PCAOB should consider steps that will more fundamentally align the auditing profession with the interests of investors.

The first step, as discussed above, is to eliminate the bond between auditor and company through the payment mechanism. Obviously, this is not a simple task and it would require lawmaking that is far outside of the PCAOB's powers. At the same time, it *is* within the PCAOB's role to broach this subject with its constituents and lawmakers. Other payment mechanisms are possible and should be explored. For example, the concept release mentioned one proposal for "financial statement insurance" whereby companies would purchase such insurance against investor losses caused by misrepresentation in financial statements. Insurers would appoint and pay auditors to examine and attest to the financial reporting. The insurance carriers would have a strong, financially-driven interest in the outcome of every audit and thus would be willing to pay for high-quality audits. The auditors would have a profit incentive for performing the best audit possible – and it would also be in the interest of their own self-preservation. Investors would benefit from this alignment of interest between principals (insurers) and agents (auditors).

The second step would be to create audit-only firms from the existing multidisciplinary firms. The scenario described above would probably fail if auditing firms were able to distract themselves from performing audits at a price that compensates them fairly for a quality service commensurate with the risks involved. A multidisciplinary firm might be tempted to cut its fee on a particular audit engagement – and consequently trim its workload so as to make it profitable – if it wants to garner a particular audit client. There are several possible reasons a firm might be willing to do this: perhaps to demonstrate a certain industry expertise, or to be associated with a particularly prestigious company to capture its “halo”. Whatever the reason, audit fee compression – which could directly affect the quality of the audit work performed – becomes a greater possibility when the firm can look to other revenue sources that could effectively subsidize the auditing business. That possibility exists, even if those revenue sources emanate from clients outside of the audit client base.

Furthermore, the PCAOB should have complete visibility into the financial workings of such audit-only firms. At the current time, the PCAOB regulates auditing firms but is not privy to their complete financial status. To maintain its role as the auditing profession’s regulator, it should have access to timely and full financial statements for their review. Audit-only firms with unstable financial structures might perform lower-quality audit work if facing financial distress. Without full financial reporting to the PCAOB, it is hard to see how the regulator can effectively isolate which firms may be risking the quality of their audit work because of concerns with financial position and liquidity. In fact, even *without* a breakup of the firms, it’s hard to understand how the PCAOB can do this at all in the current non-reporting environment.

Breaking apart multidisciplinary auditing firms is, once again, an action that would be outside of the PCAOB’s authority. Nevertheless, the PCAOB is the right party to instigate actions on the part of those who can break up the firms.

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To sum up, while the goal of increasing auditor independence through auditor rotation is the right objective, I believe the benefits derived from it would be minimal. Audit fees would likely increase, but this is not a bad outcome: audit fees should be higher, but for the right reasons. Disruption and inefficiencies would be likely outcomes of auditor rotation, and this would be reflected in the audit fees. Yet investors should be satisfied if audit fees increase because auditors are acting in their interests and charging for a real service to them. I believe the PCAOB should focus less on auditor rotation and more on initiating a serious dialogue about the way the auditing profession should be structured and compensated. In my view, that is the only way meaningful changes will be brought about that will provide market confidence in the work of the auditors.

If you have any questions or care to discuss my views further, please do not hesitate to contact me. Best regards.

Sincerely,

Jack Ciesielski

Jack Ciesielski
jciesielski@accountingobserver.com