



December 13, 2011

Office of the Secretary  
PCAOB  
1666 K Street, N. W.  
Washington, D. C. 20006-2803

Re: Rulemaking Docket 37

Board Members:

We appreciate the opportunity to comment on PCAOB Release No. 2011-16, Concept Release on Auditor Independence and Audit Firm Rotation (“Concept Release”). Our comments are primarily from the perspective of an audited public company based on our experience as (i) the principal accounting officer with responsibility for accounting, reporting and the audit relationship, (ii) a current audit committee chairman and former principal financial officer with responsibility for accounting, reporting and the audit relationship and (iii) a current audit committee chairman who is also a current principal executive officer and former principal financial officer with responsibility for accounting, reporting and the audit relationship.

The Concept Release states that the PCAOB is “issuing a concept release to solicit public comment on ways that auditor independence, objectivity and professional skepticism could be enhanced.”<sup>1</sup> Further, it is noted that mandatory audit firm rotation is “[O]ne possible approach on which the Board is seeking comment”<sup>2</sup>. Upon reviewing the Concept Release, it appears that the concerns of the Board are much broader and include a discussion of the quality of public company audits and protecting investors and whether requiring mandatory audit firm rotation provides the best avenue for addressing issues (i.e., the Board’s stated concerns relating to auditor independence, objectivity and professional skepticism) which impact these items. Specifically, the Concept Release poses the following questions.

- “whether and how mandatory rotation would serve the Board’s goals of protecting investors and enhancing audit quality.”<sup>3</sup>
- “whether mandatory auditor rotation would significantly enhance auditors’ objectivity and ability and willingness to resist management pressure.”<sup>4</sup>
- “whether a periodic ‘fresh look’ at a company’s financial statements would enhance auditor independence and protect investors.”<sup>5</sup>

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<sup>1</sup> See Concept Release, I. Introduction, Page 2, paragraph 3

<sup>2</sup> *ibid*

<sup>3</sup> See Concept Release, I. Introduction, Page 3, last paragraph

<sup>4</sup> See Concept Release, III. Audit Firm Rotation, D. General Questions, Page 17, paragraph 1

<sup>5</sup> *ibid*, paragraph 3

In developing our comments, we have given consideration to the roles of the following entities and perspectives relative to the content of the Concept Release to address the issues of audit quality, protecting investors and mandatory audit firm rotation.

- The Securities and Exchange Commission (“SEC”) has oversight authority over the PCAOB and appoints the accounting standards setting body, the Financial Accounting Standards Board (“FASB”), that establishes generally accepted accounting principles (“GAAP”) for the United States of America (“US”).
- The PCAOB has authority to regulate registered public accounting firms (“auditors” or “audit firms”) and “oversee the audits of public companies in order to protect investors and the public interest by promoting informative, accurate, and independent audit reports.”<sup>6</sup>
- Registered public accounting firms audit entities that file reports and financial statements with the SEC.
- Audit Committees of public companies are required to be independent of management and are “directly responsible for the appointment, compensation, and oversight of the work of any registered public accounting firm employed by that issuer (including resolution of disagreements between management and the auditor regarding financial reporting) for the purpose of preparing or issuing an audit report or related work, and each such registered public accounting firm shall report directly to the audit committee.”<sup>7</sup> Further, audit committees have oversight over an audited entity’s financial reporting and related activities.
- Investors (i.e., company share or unit holders), creditors and the investing public have an interest in the financial statements of a public company and the related audit reports issued by a registered public accounting firm.

The following sections address auditor independence, mandatory audit firm rotation, audit quality, protecting investors and other considerations in response to the Concept Release.

### Auditor Independence and Objectivity

The SEC, PCAOB, NYSE and NASDAQ have specific requirements and/or rules related to auditor independence which are intended to govern the relationship between the audit firm and its public company clients. These requirements and/or rules include, but are not limited to, (i) prohibitions on financial ownership in clients, (ii) prohibitions on provision of certain services including non-audit services, (iii) required time-based rotations for lead and concurring audit partners, (iv) a specified “cooling off” period for audit engagement personnel hired by clients, (v) required mandatory audit committee communication and (vi) audit committee pre-approval of services provide a framework of audit firm independence from public company clients.

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<sup>6</sup> See PCAOB Mission, <http://pcaobus.org/About/History/Pages/default.aspx>

<sup>7</sup> See Sarbanes-Oxley Act of 2002, Sec 301. (2)

In the Concept Release, there is no discussion around the framework of audit firm independence from public company clients. The focus is on concerns related to objectivity and professional skepticism, the measurement of which can be highly subjective. Objectivity and professional skepticism are specifically addressed in PCAOB Rules 3500T (Interim Ethics Standards) and 3200T (Interim Auditing Standards), respectively. The PCAOB's rules relating to objectivity and professional skepticism are longstanding standards related to the practice of auditing.

Some of the concerns regarding auditor objectivity and professional skepticism appear to be related to issues raised by the Working Group on "Lessons Learned from the Financial Crisis" ("Lessons Learned Working Group") of the PCAOB's Investor Advisory Group's ("IAG") which stated at the March 16, 2011 IAG meeting that "serious questions have been raised both about the quality of these financial institutions' financial reporting practices and about the quality of audits that permitted those reporting practices to go unchecked"<sup>8</sup>. However, we note:

- On September 29, 2010, the PCAOB issued PCAOB Release No. 2010-006, "Report on Observation of PCAOB Inspectors Related to Audit Risk Areas Affected by the Economic Crisis"<sup>9</sup> which addresses certain areas of concern raised by the IAG's Lessons Learned Working Group.
- The audit firms mentioned in the IAG's Lessons Learned Working Group slide presentation have undergone PCAOB inspections which included review of certain issues raised by the IAG's Working Group on "Lessons Learned from the Financial Crisis".

Based on the available public record, it appears that the PCAOB has followed its established protocols with respect to the issues raised by the IAG's Lessons Learned Working Group.

With regard to addressing concerns on auditor independence, objectivity and professional skepticism, we believe that the rules are already in place, should be enforced and the most effective tools available to the PCAOB currently appear to be its ongoing inspection and enforcement processes and ability to discipline audit firms and their affiliated personnel for deemed audit failures. Before the PCAOB creates additional layers of rules or takes other broad-based actions, such as requiring mandatory audit firm rotation, it should complete open issues, if any, related to its established protocols. We also note that there is no position or statement presented in the Concept Release by the PCAOB's Standing Advisory Group ("SAG") and hope that the PCAOB would formally avail itself of the views of the SAG before it moves forward with any actions related to mandatory audit firm rotation.

### Mandatory Audit Firm Rotation

The Concept Release discusses the historical context relating to prior discussions and proposals for mandatory audit firm rotation. The current impetus for considering mandatory audit firm rotation appears to be driven by the input from the IAG's Lessons Learned Working Group as discussed above.

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<sup>8</sup> See Concept Release, footnote 70, page 33 and 34

<sup>9</sup> [http://pcaobus.org/Inspections/Documents/4010\\_Report\\_Economic\\_Crisis.pdf](http://pcaobus.org/Inspections/Documents/4010_Report_Economic_Crisis.pdf)

The IAG working group has taken an issue that relates to financial institutions during the 2008 financial crisis and seems to extrapolate those behaviors across all public companies and the audit teams that serve them. Further, the PCAOB notes “the Board's inspections are not random, the Board may be looking at the most error-prone situations. The root causes of audit failures are complex and vary in nature and continue to be explored by the Board.”<sup>10</sup> When these items are considered together, it may consequently narrow the focus of the PCAOB’s basis for considering mandatory audit firm rotation.

Further, the IAG working group presupposes that mandatory audit firm rotation will result in increased auditor independence, objectivity and professional skepticism as well as enhanced audit quality but has no empirical evidence to support their position. Finally while it can be assumed that a public company’s changing audit firms will result in higher overall costs of the audit process, there is no basis for determining that any offsetting benefits will accrue to the investors or creditors through enhanced audit quality or improved quality of information.

Audit committees of public company are subject to statutory requirements under the Sarbanes-Oxley Act of 2002 and regulatory requirements of the NYSE and/or NASDAQ. Independence, objectivity and professional skepticism are qualities required of both the audit firms and the members of public company audit committees as independent directors in the performance of their duties. Further based on our personal experiences, audit committees expect the principal financial officer and principal accounting officer to exhibit these same qualities in the execution of their duties.

We believe that the determination of whether a public company’s audit should be put out for bid or the incumbent audit firm replaced should be the decision of the audit committee based on their review of the audit relationship and the recommendation of company management, as appropriate. Imposing mandatory audit firm rotation or setting other limitations on the ability of the audit committee to determine who a public company’s audit firm will be undermines the audit committee’s independent nature and authority, and alters statutory requirements under the Sarbanes-Oxley Act of 2002 and regulatory requirements of the NYSE and/or NASDAQ.

### Audit Quality

The issues related to audit quality are multi-faceted and range from the promulgation of US GAAP by the FASB to professional judgments and interpretation of US GAAP by company management, the auditor and the PCAOB inspectors to the structure and operation of audit firms.

As a general observation, US GAAP is complex, heavily rules-based and in its current form is fraught with numerous special situations and exceptions to the general rule and the concept of substance over form. US GAAP does not address every circumstance and where an item is not specifically addressed, existing US GAAP is to be applied by analogy unless specifically prohibited. This is the backdrop in which accounting and reporting decisions are made by company management and in which audits are performed by the auditor. Many areas of US GAAP are subject to professional judgment and interpretation by company management, the auditor and the PCAOB inspector – in hindsight – based on known facts and assumptions at the time the professional judgment and interpretation is made. Over time additional facts may

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<sup>10</sup> See Concept Release, II. Auditor Independence, page 6

become known and assumptions may change. For recurring items, the known facts and assumptions are updated and the accounting and reporting treatments revised over time to reflect changes in circumstance. For non-recurring items, it is not wholly surprising that differences may come to light from the time the initial accounting and reporting determination is made and audit work is performed to the time of a PCOAB inspection.

With respect to the structure and operation of audit firms, they are partnerships and for-profit services businesses which are subject to staffing and knowledge base issues due to loss of experienced staff for various reasons. As partnerships, each partner within an audit firm has a certain amount of autonomy in audit decisions. Our experience is the audit firm is a “brand” with each audit partner acting as a separate firm operating within the brand – in essence, when the lead audit partner changes, this may be akin to an audit firm rotation. As for-profit businesses, the audit firm and their employees make personnel and personal decisions, respectively, which impact the audit firm’s available staffing and knowledge base. While it would be ideal if an audit firm could staff an audit with experts in the business being audited, this is not realistic for a number of reasons – the audit firm’s focus and training is primarily on auditing, the cost and time to train its employees to become experts in a business is uneconomical for the audit firm and audit firm staff often work on multiple clients that are not necessarily in the same industry.

While there are no simple fixes to the issues around US GAAP, professional judgments and interpretation of US GAAP and the structure and operation of audit firms, the PCAOB can address and impact audit quality concerns. In the near term, specific actions the PCAOB can take include:

- Periodically develop and communicate to the audit firms and audited entities a coordinated issues list, similar to the Internal Revenue Service’s coordinated audit issues list provided to taxpayers, of the positions the PCAOB has taken on inspection results to set expectations with the audit firms and audited entities going forward.
- Communicate the results of a PCAOB inspection directly to an audited entity’s management and its audit committee or require the audit firm to do so to ensure a clearer understanding of potential issues and concerns raised in an inspection.

Longer term items that the PCAOB should address include:

- Updating generally accepted auditing standards (“GAAS”) and related practices. While business transactions and the related practices and processes have evolved and the technology supporting those practices and processes has changed as well, there appears to have been minimal change to GAAS or audit practices.

The type and degree of audit and intensity of audit procedures should be based on specific client situations including industry characteristics and the underlying systems and controls of the client. Any area where GAAS stipulates a specific procedure sets a boilerplate approach of all audits and is an impediment to professional judgment. A good example is confirmations under PCAOB Rule 3200T (Interim Auditing Standards) as an audit process. The confirmation process is generally applied to accounts receivable and

is based on sending documents to third parties requesting a response and performing an alternate procedure (usually vouching cash receipts) if no response is received. In reality, many companies collect their receivables within 30 days and the vouching of cash can be automated to “confirm” the existence of receivables and thereby eliminate the rote confirmation process as commonly applied in audits.

Enhancing audit quality through updating GAAS could eliminate the meaningless checklist audit activities that do not necessarily relate to the business, systems and control risks under audit and focusing efforts on the real issues and risks related to the business, systems and controls.

- As the SEC and FASB address convergence with International Financial Reporting Standards (“IFRS”) and the potential impacts to US GAAP, the PCAOB should be considering how the transition will impact the audit firms, audited entities and audit quality. Depending on the anticipated timeframe and perspective of the impact of IFRS, this may be a potentially more pressing issue than addressing mandatory audit firm rotation.

### Protecting Investors

As users of financial information, investors care about the quality of the information provided to them in financial statements of audit entities. Ideally, enhancing audit quality will improve the quality of information provided to investors. However, it should be noted that the investors ultimately bear the costs of any actions taken by the PCAOB to enhance audit quality and, at a minimum, should receive an improved quality of information.

We believe requiring mandatory audit firm rotation will increase direct and indirect costs of audits to public companies and has the potential to increase audit risk in the front end of the new audit relationship. The key factors are loss of any continuity of audit staff and understanding of the business and underlying risks particular to the public company. We do not believe that mandatory audit firm rotation would necessarily enhance audit quality based on the increased audit risk and, in the short term, may very well reduce audit quality. Additionally, it would not necessarily address the issues of auditor objectivity and professional skepticism.

The PCAOB needs to carefully consider the impact of any action it may take in an attempt to improve audit quality. If a contemplated course of action is not significantly likely to improve the quality of the information provided to investors as well as enhancing audit quality from the PCAOB’s perspective, the PCAOB should carefully weigh the costs and value of the course of action being contemplated before requiring any change be enacted.

### Other Considerations

The prohibitions on provision of certain services including non-audit services by an audit firm to audits clients is another area that may need to be reconsidered. Many audited public companies choose to be audited by Big 4 audit firms – a perceived gold standard in terms of quality. In our case, our auditor is PricewaterhouseCoopers (“PwC”). As a matter of policy, we have decided to (i) limit all non-audit services provided to PwC including allowed Tax services, (ii) use Deloitte

& Touché (D&T) as our tax advisor and (iii) keep at least one Big 4 firm fully independent of us with respect to PCAOB rules.

If mandatory audit firm rotation is required, a public company's choice of providers for certain services including non-audit services provided by the registered public accounting firms will be limited unless the SEC, PCAOB, NYSE and NASDAQ reconsider their auditor independence rules. We believe that audit costs will rise due to reduced competition, while audit risk may increase and audit quality will be reduced because the available firms may not have personnel with appropriate technical competence and experience to meet the needs of public companies and their investors.

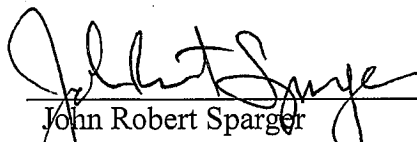
### Summary

We do not support mandatory audit firm rotation and believe that PCAOB should focus its actions on enhancing audit quality in other efforts including, but not limited to:

- Developing and communicating a coordinated issues list, similar to the Internal Revenue Service's coordinated audit issues list provided to taxpayers, of the positions the PCAOB has taken on inspection results in order to set expectations with the audit firms and audited entities going forward.
- Updating generally accepted auditing standards ("GAAS") and related practices to reflect the evolution of business transactions and related practices and processes and the technology supporting those practices and processes.

Further, we believe requiring mandatory audit firm rotation will increase direct and indirect costs of audits to public companies, has the potential to increase audit risk in the front end of the new audit relationship, would not necessarily enhance audit quality based on the increased audit risk and, in the short term, may very well reduce audit quality and does not effectively address the issues of objectivity and professional skepticism.

Sincerely,

  
\_\_\_\_\_  
John Robert Sparger  
Senior Vice President and  
Chief Accounting Officer  
Targa Resources Corp.  
Targa Resources Partners LP

See next page following  
\_\_\_\_\_  
Chris Tong  
Director and Chairman  
of the Audit Committee  
Targa Resources Corp.

See 2<sup>nd</sup> page following  
\_\_\_\_\_  
Barry R. Pearl  
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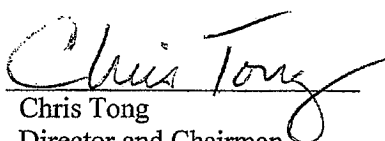
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