



FLAHERTY & CRUMRINE PREFERRED INCOME FUND INCORPORATED
FLAHERTY & CRUMRINE PREFERRED INCOME OPPORTUNITY FUND INCORPORATED
FLAHERTY & CRUMRINE/CLAYMORE PREFERRED SECURITIES INCOME FUND INCORPORATED
FLAHERTY & CRUMRINE/CLAYMORE TOTAL RETURN FUND INCORPORATED

December 12, 2011

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

Re: Concept Release on Auditor Independence and Auditor Firm Rotation Rulemaking Docket
Matter No. 37

Dear Board Members:

We appreciate the opportunity to respond to the request for public comment from the Public Company Accounting Oversight Board (the "PCAOB") on its release, *Auditor Independence and Auditor Firm Rotation* (the "Concept Release").

Each of the above named Funds (each a "Fund" and collectively the "Funds") is a registered investment company ("RIC") under the Investment Company Act of 1940 ("1940 Act"). We offer our thoughts, concerns, and recommendations on the Concept Release as it applies to RICs, but also make recommendations that we believe would apply to all those that may be impacted by such rulemaking.

The Funds do not fit well into the statistical averages for term of engagement noted in the Concept Release, as they have changed audit firms in the last 10 years and know first-hand the burdens associated with such a change. We also note the wide range in asset sizes of the Funds we oversee, from a low of \$176 million to a high of \$1.1 billion. This range of sizes offers practical insight into the disproportionate impact increased costs have on smaller funds and companies, and we will provide a more concrete numerical example later in this letter.

The Role of the Board of Directors

Before getting into the details of the Concept Release, we will highlight the role and importance of Board governance in this process. Audit Committees and Boards of Directors are given the duty to oversee management and the organization – including the audit of the financial statements. The adoption of Sarbanes-Oxley significantly expanded the Audit Committee's role in the entire audit

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process, including responsibility for the appointment, compensation, and oversight of work performed by the auditors.

We believe Directors understand the responsibilities and legal liability associated with their role on the Boards and strive to achieve effective oversight of their organizations. There have been examples over time where Directors have not lived up to the standards expected of them and many of these problems have manifested themselves in audited financial statements (or perhaps more often the lack of inclusion in financial statements for off-balance-sheet transactions). We believe, however, that most Boards fully appreciate their role and apply the due amount of diligence to the audit process.

Given our view, we would caution that rulemaking in the accounting profession should not be a substitute for addressing weaknesses in Board governance. No amount of rulemaking can take the place of diligence on the part of a Board of Directors and Audit Committee, and we comment later on possible enhancements to assist Directors in executing their duties.

While Sarbanes-Oxley included a number of items directed towards accounting/audit, we believe it was as much a movement to improve corporate governance – while leaving the decision-making responsibility with the Board. We believe regulatory provisions such as mandatory firm rotation would be an admission that the Board of Directors is not capable of making these important decisions.

Exclusion of RICs from Audit Firm Rotation

In reference to Question #6 in the Concept Release, we believe the PCAOB should consider an exclusion from any audit firm rotation requirement for RICs. There are various factors that distinguish RICs from other operating companies. RICs are subject to substantial SEC oversight, and GAAP for RICs is largely dictated by the SEC and AICPA requirements. Further, as part of Sarbanes-Oxley the SEC requires public companies to be audited by a PCAOB-registered audit firm. Assets and liabilities in RICs are marked-to-market and there are few alternative accounting policies that would significantly impact financial reporting. Disclosure requirements have also increased substantially over the last five years, even for use of the most complicated securities and derivatives.

For the Funds, one of the most important functions of auditors is their review of the valuation of assets and liabilities. The standards of review in this area are very high and have been greatly enhanced in the last five years with our audit firm broadening their available resources and increasing the level of expertise they maintain inside the firm. They have demonstrated a commitment to the level of independence required for their results to be credible, and have invested substantial resources in improving these processes.

Cost/Benefit Analysis for RICs

We also draw attention to the cost/benefit analysis of audit firm rotation as it relates to RICs in general and also the relative size of the RIC. We encourage the PCAOB to further examine the cost/benefit, as

the Concept Release did not adequately quantify the expected costs associated with the proposals: Costs associated with the audit function are easily measured numerically at the Fund level, but as we have seen with Sarbanes-Oxley there are numerous costs that must be borne by other parties involved in the process. In the case of the Funds, those costs are shared by the Fund's investment advisor, and service providers. In both cases the costs are significant, tend to be absorbed within the context of existing fee schedules, and do not show up as additional costs in the Fund's financial statements. These costs are often difficult to estimate as they involve as much opportunity cost as they do direct expenses. Nonetheless, these are economic costs that should be factored into a cost/benefit analysis. A one-size-fits-all approach to this proposal could turn out to be terribly costly for small companies.

While Sarbanes-Oxley was far-reaching in comparison to these proposals and is only of limited use for cost comparison purposes, it is only logical to assume there would be an increase in audit fees associated with these changes. More frequent rotation of clients would likely require a greater staffing level. It is likely audit firms would attempt to utilize technology to keep overall implementation costs down, but technology solutions also require resources and would likely result in higher costs over time.

As discussed earlier, the Funds we represent vary greatly in size. Increased fixed costs of any kind have a disproportionate impact on the smaller Funds. For the sake of example, let's assume that audit-related costs increase by 20% as a result of increased requirements on independence and audit firm rotation. For our smallest Fund this increase in audit-related costs would result in an increase in the total Fund expense ratio of 0.9 basis points (0.009%). The same percentage increase in audit-related costs for our largest Fund would result in an increase in the total Fund expense ratio of 0.16 basis points (0.0016%).

While these numbers may seem small in the aggregate, they are increases nonetheless and we believe there has been no demonstration of a benefit to be received in return for these extra incurred expenses. As mentioned before, these represent only the quantifiable costs at the Fund level and ignore other economic costs that are borne by other parties. Finally, given these costs are mostly fixed-rate in nature, there is a disproportionate impact on smaller funds and corporations.

Existing Auditor Independence Standards

Since the adoption of Sarbanes-Oxley and formation of the PCAOB, auditor independence and quality of services provided by an audit firm have improved materially. We have observed the evolution of independence monitoring within the audit firm and the effective deployment of technology to assist in this oversight. We have witnessed an elevation of standards in audit testing and review that has resulted from the increased oversight of the PCAOB and the feedback loop created by the audit review process.

The existing audit partner rotation requirements, combined with the normal personnel turnover in the audit industry, have resulted in a reasonable amount of rotation in the people involved in auditing the Funds. Since we last changed audit firms in 2001, we have worked with two different lead audit

partners – and we are approaching a change to our third lead audit partner in 2012. There has been at least the same number of changes in the role of concurring audit partner. Similarly we have had two changes at the senior staff level of the audit firm and would expect our third change within the next two years. There have been even more changes at the accounting staff level of the firm that is involved in the daily activities of the audit testing. It is difficult to quantify given the lack of details available to clients, but it is safe to presume there have been other similar changes in supporting areas within the firm, such as the valuation specialists who work to support the audit testing procedures.

Please note that the rotation requirements that led to the personnel changes mentioned above for audit partner and senior staff already include the important concept of overlapping coverage within the audit firm. It has been acknowledged that it is important for there to be continuity when making changes to audit personnel, so the senior staff is on a 7 year mandatory rotation while the audit partner is on a 5 year rotation.

We believe that there has been a material change in the audit industry and in the expectations of audit clients. This natural and mandated rotation within an audit firm today helps ensure that the review process does not stagnate. There also appear to be more “touch points” within the firm for any given client, which means more levels of internal controls are built into each area of expertise within an audit firm.

There is no question that errors will continue to occur, but we believe the PCAOB’s continued focus on audit improvement, the competition evident in the audit industry, and the diligence of the oversight function performed by the Board of Directors provides a reliable and sustainable overall audit result.

The experiences we described above have led us to conclude that audit partner rotation requirements are about as short as could be tolerated. The change in lead audit partner is a time-consuming process and demonstrates that there is a learning curve in bringing a new partner up-to-speed on the complexities of any given audit. We believe that extending this audit partner rotation by a couple of years would be beneficial to all parties. However, given that is not the focus of this Concept Release, at a minimum we believe the experience provides insight into the proposed 10-year audit firm rotation and leads us to a conclusion that 10 years is too short a period.

Audit Firm Rotation and Tenure

It is our view that one of the most effective ways to ensure audit excellence is to encourage a competitive marketplace for audit firms. The marketplace needs to be comprised of a sufficient number of audit firms to offer competitive alternatives to clients. Auditors need to compete for the business of clients, and over the long run the only way to keep an audit client is to do excellent work and charge reasonable fees for those services.

Mandatory audit firm rotation, and specifically the concept of firm tenure, seems to reduce the incentives of audit firms to produce the best product. Audit firms will have their own initial costs (including opportunity cost) in bringing on a new client, and they would reasonably expect to cover those costs from their fee schedules over time. However, they should not be guaranteed this result if they are not living up to the standards required by the client.

In a competitive marketplace every firm (regardless of industry) must deal with the costs associated with client acquisition, but they also must perform at the highest level to be able to earn a return on that investment. The decision to maintain an auditor should be dependent on performance and must remain at the discretion of the Audit Committee.

Alternative Recommendations

We mentioned earlier the role of the Audit Committee in auditor selection and oversight and believe that this is where the decision-making should remain. However, our experiences have led to the conclusion that one difficulty in the process is the amount and quality of information available to support the Directors in this role. The information available from the PCAOB and the audit firms has improved significantly since Sarbanes-Oxley, but the importance of accurate and sufficient information to the client should not be overlooked.

Many times we have reviewed the public portion of the PCAOB inspection reports and asked the same questions. Were our Funds' audits selected for review by the PCAOB? What type of audit client was involved? How similar is the client's business to ours? Is the client a RIC or operating company? What led the PCAOB to review this area of the audit and could we have been asking similar questions? We understand the need to have some portion of the PCAOB review remain private and are not advocating for a change necessarily. However, we recommend that the PCAOB look at the decision-making process from the point of view of the Audit Committee and ask whether there is sufficient information to make an informed decision.

If a client did not experience issues with its own audit, then it will not be inclined to change audit firms just for the sake of change. However, if they knew of audit issues related to other clients that could then be applied to their own diligence, they could at least be focused on the issue and be having a dialogue with their auditors to ensure similar problems are addressed. It seems reasonable that more scrutiny of errors by audit clients could perhaps lead to less recurrence of those errors in future audits. This is not to minimize the role and process of the PCAOB, but client scrutiny may rise to a different level.

One recommendation might be to inform the actual audit client of deficiencies if that client's audit was selected by the PCAOB for review. This would limit the dissemination of the disclosure while at the same time provide meaningful feedback to the audit client and provide an even greater incentive to the audit firm to maintain the highest of standards.


The goal should be to broaden and improve the feedback loop associated with auditors, their clients, and oversight organizations like the PCAOB.

Conclusion

We strongly support the mission of the PCAOB to increase the quality of audit services for all clients, but we do not believe the current proposals in the Concept Release will advance that goal. Audit Committees have been given the responsibility to select auditors, set compensation for services, and review the quality of services provided. If auditors fall short on any of the performance factors then the Directors have the ability to make a change in audit firms at that time. Rather than restricting the ability of the Directors to make this decision, we recommend the PCAOB consider ways to assist the Directors in making *informed* decisions.

Conflicts of interest are a problem in many areas of business, and the client-auditor relationship is no exception. We believe the goal should be to *manage* the conflicts. Sarbanes-Oxley was a giant step in the right direction and included necessary controls and provisions to refocus the auditor on maintaining their client relationships (and revenues) through excellent performance rather than considering each client as an annuity. Communication is a key element to managing conflicts and we believe this should be an area of continued focus for the PCAOB. If the Directors are well informed, the auditors have to compete for business in a competitive marketplace, and the PCAOB continues to provide oversight to the industry, then conflicts will be appropriately managed and the focus of all parties will be on providing the highest quality of service.

Sincerely,



Robert T. Wulf, Audit Committee Chair
Morgan Gust, Audit Committee Member
David Gale, Audit Committee Member
Karen H. Hogan, Audit Committee Member