

**From:** [jncole3@gmail.com](mailto:jncole3@gmail.com) on behalf of [Jason Cole](#)  
**To:** [Comments](#)  
**Subject:** PCAOB Auditor Independence and Audit Firm Rotation  
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## **PCAOB Rulemaking Docket Matter No. 037**

Board Members:

Thank you for the opportunity to present my opinions on the topic of enhancing auditor independence and professional skepticism, as well as the notion of mandatory audit firm rotation. As a current Masters of Accountancy student at the University of Georgia, I would first like to emphasize that I realize I do not possess sufficient professional experience to provide empirical data or potential first-hand implications of implementing mandatory firm rotation. However, as I near my graduation, I felt it prudent to offer the perspective of a young and rising professional on this matter. The following are my individual opinions and are not in anyway representative of any other body.

There is no arguing that auditor independence is paramount in maintaining the value of an auditor's attestation to a company's financial position. In the same breath, a sufficient level of professional skepticism is one of the pillars that uphold auditor independence, as set forth in the auditing standards. I am completely in favor of new methods of protecting the independence of mind that auditors need to be effective, but as I will explain, mandatory audit firm rotation is not the best way to do so.

### Role of the Auditor

In reading the concept release, there seems to be a fundamental misalignment at the heart of this issue. It is very disconcerting that there seems to be, in some cases, a fairly large disconnect between regulators and practitioners as

to the responsibilities of an auditor. As quoted in the release on Page 4, the U.S. Supreme Court makes it very clear that the allegiance of the auditors ultimately lies with the creditors and stockholders of the company being audited. I recognize the presence of the “inevitable pressures” that auditors face as a result of this public responsibility coupled with the desire for good client service. The client pays for the audit service, and the inherent tendency is to give heed to the desires of “him who has the dollar.” And while in a perfect world the desires of the shareholders and the desires of management would neatly align, individuals tend to act in their own self-interest regardless of the interests of other related parties. Therefore, discrepancies do exist at times between the desires of the investing public and the desires of management, placing inescapable pressure on the auditor to satisfy both. Even so, the difficult nature of a necessary task is not a valid reason to deviate from the goal or purpose of that task. Yes, there is pressure, but independent auditing is meant to add credibility to the data within the financial statements, for the betterment of their users. That is clear.

That said, the press release also noted research studies that have identified many cases of audit deficiency in the last several years. The finding that stood out the most was in regard to their inspection of firms’ initial proposals to potential audit clients (Page 7). The listed phrases used by one audit firm (below) bothered me, and I have bolded the most concerning words:

- • Your auditor should be a **partner** in **supporting and helping [the issuer] achieve its goals**, while at the same time helping you better manage risk;
- • **Support the desired outcome** where the audit team may be confronted with an issue that merits consultation with our National Office; and
- • Stand by the conclusions reached and **not second-guess our joint decisions**.

These phrases do not support the notion of professional skepticism. Having an auditor help to achieve a company’s goal is more of a consulting role and blatantly violates the purpose behind independence. Auditing is an attestation to the information presented in the financial statements and in no way should be a cooperative (between client and firm) or goal-oriented task. Supporting any one outcome over another is an indicator of bias that will naturally hinder the ability to accept any possible evidence that opposes that particular outcome. Also, second-guessing is a large part of what it means to have professional skepticism. To not

second-guess effectively means to not be skeptic. These mentioned characteristics do not support or encourage an independent mindset for an auditor and directly conflict with the chief responsibility of an auditor as described previously.

I emphasize that I am not attempting to extrapolate such a mentality across all auditors. As a future public auditor, I am by no means trying to demean the profession or speak poorly about anyone. I know that the comments above are indicative of one case in isolation. However, the comments made do not agree with what I have been taught in school about the role of auditors (which is more in agreement with the Supreme Court). Additionally, while much more research is required to make any conclusion, I believe the prevalence of audit deficiency found by regulators internationally gives cause for concern about this apparent disagreement as well. Bridging this disparity would help fortify and maintain independence in practice, and any proposal for improved independence regulations should be aimed at this realigning this fundamental disagreement.

#### Comparison to Regulations Already in Place

I believe the audit regulations set forth by the PCAOB and SEC to date have done an excellent job of enhancing the preservation of auditor independence. The "Dos and Don'ts" for auditors on an engagement are very specific and detailed in order to prevent situations in which independence could be impaired. When contemplating the impact of a new independence standard, it is important to consider its effects in relation to standards already in place. As I am prepared to explain, I believe adding mandatory audit firm rotation to the mix will create more conflict with these existing regulations than it will supplement their overall effectiveness.

One current independence safeguard is the prohibition of direct investment by covered persons in a firm's audit clients. This is obviously in place to prevent conflicts of interest for the auditors. It does not make sense for an auditor to have any incentives connected to the performance of their client. Mandatory audit firm rotation would increase the difficulty of obeying this rule. If clients are consistently rotating and changing auditors, the auditors for any given firm (as well as their family members, etc.) will not be able to invest in most companies, or at the least will potentially have to alter their portfolios frequently in order remain compliant with

the investment stipulations. As each rotation cycle changes, more work and documentation would be required by the firms in order to make sure that covered persons maintain their appropriate standing.

Another independence regulation placed on audit firms is the limitation on providing certain non-audit services to audit clients. Similar to the conflict mentioned above, audit firm rotation will cause a lot of switching back and forth of which services a firm can provide to different clients. Depending on the staggered rotation cycle deemed appropriate, the fluctuation in audit clients will first of all increase the competitive nature of firms trying to acquire clients for these non-audit services. The marketing aspect of the firms could greatly increase. Consequently the change in availability of non-audit services carries the risk of increased volatility in the firm's revenue streams. Earning level revenue streams is a benefit that proponents of this rotation plan are advocating. However, I am not convinced that firm rotation will create the anticipated even revenues due to alterations in the other services provided. The extra effort of firms to smooth this volatility via acquiring new non-audit service clients could inhibit the quality of the audit work performed.

Probably one of the most important independence regulations that are already in place is the mandatory partner rotation on audit clients within each firm. This type of mandatory rotation was enacted after Sarbanes-Oxley in the early 2000s to achieve the same type of independence measures that audit firm rotation is meant to improve. It seems, though, that these rules will not be able to work together at all, as audit partner rotation and firm rotation together would cause too frequent of a change to be effective. If that were deemed the case, then audit firm rotation would probably replace audit partner rotation. Over all, I believe audit partner rotation is more effective than firm rotation (explained later). Because partner rotation has only been in place for less than fifteen years, I don't think enough time has been given to examine the effectiveness of the current rule. With only two rounds of partner rotation having taken place, it is too soon to consider such a drastic change away from what is already in place to accomplish approximately the same goal.

#### Deficiencies of Audit Firm Rotation

Having looked at some of the regulatory standards in place that would create conflict with audit firm rotation, it is necessary to address in a broader sense why the concept of audit firm rotation will not significantly enhance an auditor's independence and professional skepticism. I would like to draw attention to how the plan's "macro perspective" limits its feasibility, how the plan could weaken audit service, and how it is not compatible with the changes being considered in the audit report.

One large difference between audit firm rotation and the other independence rules mentioned above is that audit firm rotation has more of what I like to call a "macro perspective." The investment limitations, the non-audit service limitations, and the partner rotation requirements (I will refer to these as the "micro level rules") are all controls focused on the people and operations within the firm. Audit firm rotation treads outside the firm and affects the broader audit service industry as a whole. Auditing is necessarily a highly regulated service industry, and consequently there is the inevitable risk of this fact conflicting with a firm's for-profit nature. Because audit firms are for-profit organizations, there is value in being able to acquire and retain clients as a part of the firm's business and reputation. Finding a cohesive balance between the regulatory and profit-seeking aspects of the business is crucial. Regulation has the potential to go too far in trying to protect independence, to the unnecessary detriment of business strategy. Regulations need to be examined for their overall economic impact before adoption. Audit firm rotation will severely impact the retention portion of business strategy and have drastic effects on audit firm performance from year to year, especially in rotation years. All the other "micro-level" independence rules are better suited because they are intra-firm oriented, rather than directly changing the industry as a whole. The large-scale scope of audit firm rotation creates too large an impact on the audit firms for it to be worth the expected added value to independence.

As mentioned earlier, audit firms are for-profit organizations that form their reputations largely from not only the quality of service they provide but also the types of clients that they serve. As a result, many audit firms have added value to their business by developing strengths in providing audit service for specific

industries. Audit firm rotation threatens the ability to maintain and market an industry expertise because it creates an environment that mandates change. In contrast, this ability is not influenced by the "micro level rules," especially partner rotation. The strengths of a firm originate from its people. If a firm has developed an affinity for serving a certain industry, changing a partner on an engagement presents a very minor transition issue compared to changing the firm offering the service. The new partner on an engagement can still utilize the resources of the firm to continue to provide high quality service to the client. A new firm may not be as experienced in the industry of a new client to which they rotate, creating the potential for a more difficult and lesser quality audit process.

At the same time that audit firm rotation is being considered, there is a lot of discussion regarding the future of the audit report and what information it should include. As it stands now, the audit deadlines for issuing the audit report with financial statements are very condensed and time pressured, practically auditing twelve months of information over the course of two or three months. Earlier this year, Chairman Doty reported on numerous cases of people commenting on the increased inadequacy of the information presented in the audit report. Many professionals are calling for the audit report to present more explanation about how the auditors are coming to their conclusions and opinion. Depending on the result of the proposal concerning changes to the audit report, the breadth of the audit report could significantly change, possibly causing an increase in the volume of work required for auditors to present additional information. This would further increase the time crunch to complete and form a quality audit opinion for a company, especially for public companies. If any of these audit report alterations come to pass, it would further justify the cause not to implement audit firm rotation. When audit firms acquire new clients, the first audit is generally more pressured due to the time needed to become familiar with the information being audited. When coupled with the potential expansion of the audit report, I can only imagine that audit firm rotation would present an even greater host of logistical issues in trying to form an opinion on a timely basis because first-year audits would become more frequent.

By itself, there is no doubting the theoretical advantages of firm rotation in keeping a high level of independence. However, it also entails many costs, and

when considered in combination with the independence regulations already in place, firm rotation does not significantly improve the preservation of auditor independence.

### Alternative Approaches

It is true that having a periodic fresh look into the audit would be very beneficial in improving independence and preventing the “coziness” between auditor and client that regulators want to avoid, but as explained before, not through audit firm rotation. Instead, there are a few other things that I recommend for consideration.

My biggest recommendation is to reconsider the plan offered by former SEC Chairman Harvey Pitt at the Congressional hearing in 2002. He too was concerned about the market disruption that firm rotation would create in using industry expertise as a basis for a client's decision to select and retain an audit firm. As mentioned in the press release, he proposed to create new standards for the audit committee, allowing them to interview the audit firm on a regular basis in order to examine their audit quality improvement initiatives. In addition to this control, a new regulator would perform a quality control of the audit firm each year. If the audit firm were found to be performing below satisfaction, the regulator would have the authority to remove the firm from the engagement, thereby initiating the process of finding a new auditor.

I believe the audit committee is a perfect place to give more authority in helping monitor independence. The audit committee is separate from a company's management and is in charge of hiring the auditor. That said it makes sense for those who choose the audit firm to have a fair amount of responsibility governing the relationship between their company and the firm. Giving the committee an approved checklist for evaluating audit independence would go hand-in-hand with their current responsibilities regarding auditor selection decisions. The new regulator that would perform the annual quality control would serve as the “fresh eyes” in the process. However, instead of the financial statements, the fresh eyes would be

examining the auditors themselves and their policies of upholding appropriate independence and skepticism. In the event of inadequate quality controls, that regulator could invoke an audit firm change on a case-by-case basis, much less drastic than mandatory audit firm rotation.

In my opinion, this procedure creates the least amount of conflict with the independence standards already in place. It is a high quality inspection of independence and leaves the responsibility of keeping or losing a client in the hands of the audit firm and audit committee, thereby preserving any strategic expertise that an audit firm has developed to its advantage. As the development of independence regulations moves forward, I encourage the Board to keep their considerations at what I have termed the "micro level," measures taken within the firms rather than directly changing the audit service industry as a whole. Generally speaking, the broader the scope of a proposed regulation, the more difficult it will be to incorporate and the more conflict it will encounter with the other proposed rules (most of which are "micro level" anyway).

Lastly, as I am sure the Board is already doing with great diligence, I also encourage the Board to watch closely what the European Commission is doing in this regard. They have proposed a similar type of audit firm rotation, along with enhancements to their limitations on non-audit services. They have proposed the requirement for the large audit firms to separate their consulting/advisory divisions into separate entities, thereby creating audit-only firms and hopefully eliminating independence pressures. Keeping an eye on Europe's decision developments, their effectiveness, and the level of acceptability that they receive could be very valuable in a similar decision process for the United States.

In conclusion, I reiterate that I do not believe audit firm rotation is the best measure to take at this time in trying to improve audit independence regulations. Thank you for your time and consideration of my thoughts and opinions.



Best regards,

Jason Cole

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Jason Cole  
MAcc Student  
University of Georgia - Terry College of Business  
[jncole3@uga.edu](mailto:jncole3@uga.edu)