



Edison Electric
Institute

Richard F. McMahon, Jr.
Vice President

December 14, 2011

Public Company Accounting Oversight Board
Office of the Secretary
1666 K Street, NW
Washington, D.C. 20006-2803

Submitted by e-mail: comments@pcaobus.org

Rulemaking Docket Matter No. 37

The Edison Electric Institute ("EEI") respectfully submits comments on the Public Company Accounting Oversight Board's ("PCAOB") *Concept Release on Auditor Independence & Audit Firm Rotation* (the "Release"). EEI is the association of U.S. shareholder-owned electric companies. Our members provide service to 95 percent of the ultimate customers in the shareholder-owned segment of the industry, and represent approximately 70 percent of the U.S. electric power industry. EEI appreciates the opportunity to comment on this Release.

Summary

We understand that the PCAOB is interested in comments on whether mandatory auditor rotation would significantly enhance auditor independence, objectivity and professional skepticism, as well as comments on any alternative methods that may address the PCAOB's concerns. These concerns include observations that audit quality is not always sufficient, that audit evidence is biased in some situations towards supporting management's positions rather than independently developed and assessed, and that auditors fail at times to put the interests of investors ahead of clients. We recognize that auditor independence, objectivity and professional skepticism are central to the role that auditors play in our financial system. However, we do not support mandatory audit firm rotation, as discussed in more detail below.

The significant changes arising from passage of the Sarbanes-Oxley Act ("SOX"), including mandatory audit partner rotation, enhanced requirements related to committee responsibilities, increased disclosure requirements and restrictions imposed on services provided by audit firms, were instituted to improve audit quality. In our experience,

these changes have driven improvement in audits. The PCAOB inspection process also continues to drive enhancements in the audit firms' approach to performing their work. Further, SOX requirements for companies, including enhanced internal control documentation and monitoring, have also led to improvements in financial reporting quality. As discussed in the Concept Release, determining the root cause of audit failures is complex and the PCAOB plans to deepen its understanding of root causes in upcoming inspection seasons. We encourage the PCAOB to focus its efforts on the root causes of the audit failures, before considering mandatory auditor rotation. At this time, we believe the current approach for engagement and oversight of auditing firms should be retained.

Current Requirements

The Release acknowledges that not all audit deficiencies detected by the PCAOB inspection staff necessarily result from a lack of objectivity or professional skepticism, but rather could “reflect a lack of technical competence or experience, which may be exacerbated by staffing pressures or some other problem.” The Release also notes that because the PCAOB’s inspection program is risk-based, it may be looking at “the most error-prone situations.”

Before addressing whether significant further enhancement of auditor independence, objectivity and professional skepticism is necessary, we should first consider the Securities and Exchange Commission (“SEC”) and PCAOB's standards on these attributes, including:

- Auditor communications with audit committees regarding independence;
- Prohibitions on hiring former auditors, including cooling-off periods; and
- Prohibitions on the types of services auditors can provide, including providing tax services to those in financial reporting oversight roles

Further, existing rules requiring partner rotation as a result of SOX and the effects of PCAOB oversight of external auditors serves to encourage these characteristics. Finally, the passage of SOX has had a significant effect on the role of the audit committee, including a requirement to review the independence and qualifications of auditors prior to retaining the auditor and their responsibility to pre-approve all audit and non-audit services provided by the auditor. While there may be some additional requirements that could provide incremental benefit, our member companies generally believe that these existing requirements serve to encourage sufficient auditor independence, objectivity, and professional skepticism.

Mandatory Audit Firm Rotation

It is our view that any change undertaken to potentially enhance auditor independence, objectivity, and skepticism be made in light of whether significant improvements to audit quality (and by extension, reported financial information) will result. Mandatory audit firm rotation has been considered at various times in developing audit standards; several arguments opposing it are acknowledged in the Release. Although many of these concepts are known, we offer the following:

- Mandatory rotation removes the knowledge base and understanding developed by the audit firm, which threatens audit quality and effectiveness. Performing a high quality, effective audit depends on an auditor's detailed understanding of an entity's operations. In the first few years of an audit engagement, audit firms are less able to effectively identify risks. This is particularly important for industries such as ours which are highly regulated and specialized in terms of the services and products we offer.
- Industry expertise may be concentrated in a small number of firms. For the electric and gas utility industry, two of the largest four firms audit the majority of related companies. This expertise cannot be supported without an underlying array of audit engagements in the given industry/sector. This expertise would inevitably be eroded in a mandatory rotation regime and, in the near term, rotation is not a practical option.
- Significantly higher costs would be incurred to change audit firms. The firms would incur significant costs to get up to speed on new clients' issues and risks and to develop initial audit plans and workpapers, in addition to auditing opening balances. Companies would also expend significant time and effort to support the transition. Although this activity occurs naturally under voluntary auditor change, such change is often planned well in advance and timed based on company activities.
- Practical challenges may also exist as a result of mandating firm rotation. Companies (especially larger ones) use multiple firms for audit and non-audit services. Mandatory rotation would create significant complexity in selecting firms to provide advisory and other services in order to maintain independence from more than one audit firm.

Mandating audit firm rotation also curtails and undermines the audit committee's responsibility to select and monitor the effectiveness of the auditor. The audit committee has regular interaction with the auditor and is well-positioned to determine whether the audit objectives are being achieved. To be effective, audit committees should continue to have authority to oversee the audit process and appoint the audit firm.

Lastly, there is already a level of partner and staff change on audits due to partner mandatory rotation and normal turnover to provide the benefits of a "fresh look" at the audit approaches being applied. In practice, audit teams regularly evaluate their audit procedures and revise them to improve effectiveness and efficiency. An advantage of audit firm tenure is that the auditor gains knowledge and understanding of a company over time, and such knowledge enhances audit quality. In addition to auditor turnover, management and audit committee personnel also change over time, providing additional insights and challenging a company's financial reporting practices.

Alternative Approaches

We offer the following thoughts on alternative approaches to mandatory audit firm rotation that may be considered. These primarily focus on the audit committee's role and the PCAOB's reviews of auditors' work.

As discussed above, SOX resulted in additional responsibilities being placed on audit committees including the responsibility to appoint and monitor the activities of the independent auditor. Based on our experience, members agree that audit committees take this responsibility very seriously and actively engage with the audit teams and thoroughly review their reports. There has been significant consideration of the composition of audit committees and the type of financial or accounting expertise that should be represented. The PCAOB has recently considered whether changes should be made to auditors' required communications to audit committees. The existing requirements appear to cover the most meaningful topics (including risks identified and audit procedures applied to address those risks). However, these communications could potentially be enhanced to provide additional details to the audit committee regarding the independent corroboration and evidence the audit team has evaluated related to the most significant and judgmental areas in the financial statements. Additionally, the PCAOB inspection findings can be used to better inform the audit committee's considerations. Audit committees should have timely access to the PCAOB's inspection reports to allow for comparison of the PCAOB's findings for various audit firms. The audit committee could utilize this information to facilitate discussions with its audit team and to determine whether to consider a change of audit firms.

In the Release, it was stated that there have been instances in PCAOB inspections where evidence of a bias towards supporting management's position was identified, as well as proposal materials that indicated a willingness on the part of the auditor to partner with management that appeared at odds with applying professional skepticism. The PCAOB review procedures could focus on identifying within audits where appropriate skepticism is not evidenced and these areas could be emphasized in inspection reports. Additionally, the PCAOB should consider that the final documentation retained in audit workpapers and evaluated as part of its inspections is, based on the experiences of many

of our member companies, the end result of significant vetting of positions between the audit firm and the client. Therefore, while it may appear that the audit documentation is supporting management's position, the reality may be that the final position has been jointly considered and aligned over the course of the audit.

Conclusion

We appreciate your consideration of this issue and our comments. While we support enhancements of the attributes of auditor independence, objectivity and professional skepticism, we believe that costs incurred to support those enhancements must be justified by the benefits. We do not believe that mandatory audit firm rotation would provide sufficient benefit to overcome the significant cost and operational issues it would create. The changes to audit committee responsibilities and qualifications and auditor requirements mandated by SOX (including mandatory partner rotation, expanded audit committee communications and prohibition on performing certain non-audit activities) are sufficient at this time to ensure that the attributes of independence, objectivity and professional skepticism are appropriately applied in performing audits. To the extent audit issues are identified in PCAOB inspections, the enforcement actions available to the PCAOB appear sufficient to address them.

Sincerely,



Richard F. McMahon, Jr.