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December 14, 2011

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

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

Ladies and Gentlemen:

This letter is submitted on behalf of Business Roundtable, an association of chief executive officers of leading corporations with a combined workforce of more than 14 million employees in the United States and nearly $6 trillion in annual revenues. Member companies comprise nearly a third of the total value of the U.S. stock market. Annually, member companies pay $163 billion in dividends to shareholders and generate an estimated $420 billion in sales for small- and medium-sized businesses. Business Roundtable companies give nearly $9 billion a year in combined charitable contributions. They are technology innovation leaders, investing more than $150 billion annually in research and development – nearly half of the total private U.S. R&D spending.

We are submitting this letter in response to the August 16, 2011 concept release (Concept Release) by the U.S. Public Company Accounting Oversight Board (PCAOB or Board) to solicit comments on mandatory rotation of audit firms and other ways that auditor independence, objectivity and professional skepticism can be enhanced. We thank the Board for the opportunity to comment on this topic.

The Concept Release solicits comments on a range of questions relating to mandatory audit firm rotation and auditor independence. In order to better inform our views and assist the Board in its consideration of these topics, we distributed to members of our corporate governance coordinating committee a survey (the Survey) on their experiences with, and opinions relating to, changes in auditors. Twenty-six companies responded to the Survey, and their responses are reflected in our comments below.

While we support auditor independence, objectivity and professional skepticism and improving audit quality, we do not believe that mandating audit firm rotation is a necessary or desirable way to pursue these goals. We believe that

significant improvements in audit quality and auditor independence have occurred since enactment of the Sarbanes-Oxley Act of 2002 (the Sarbanes-Oxley Act), due in part to the Board's inspection program and its regulatory efforts. Moreover, a mandatory audit firm rotation requirement would undermine the audit committee's responsibility to engage, oversee and terminate the company's auditor, as required by the Sarbanes-Oxley Act. Equally important, such a requirement would impose significant burdens on companies without resulting in any clear benefits and likely would result in a deterioration in audit quality. Such costs of mandatory rotation would be passed on to company shareholders, and ultimately to all investors, in a time of continuing financial instability and increasing global competitiveness.

I. Mandatory Audit Firm Rotation Would Undercut The Audit Committee's Fundamental Role.

Pursuant to Section 301 of the Sarbanes-Oxley Act and implementing exchange listing standards, the audit committee is responsible for managing the company's relationship with its outside auditor. Mandating audit firm rotation would compromise the audit committee's core authority to engage, oversee and terminate the company's auditor, as required by the Sarbanes-Oxley Act. Audit committees are composed solely of independent directors who are knowledgeable about the company's business operations, internal controls and financial policies and procedures. Because of its unique position, the audit committee is best situated to make decisions with respect to audit firm tenure for a given company. Mandatory rotation could require the audit committee to engage a new firm, even when the audit committee believes the new firm is not as well positioned as the current auditor to serve the company and its shareholders. Audit committees actively evaluate auditor tenure and independence, as our Survey results indicate. Many of the companies responding to our Survey indicated that they had either changed their auditor or evaluated whether to do so during the last ten years. Protecting the audit committee's authority to manage the auditor relationship is consistent with Congress's intent in adopting Section 301 of the Sarbanes-Oxley Act, and we urge the Board to support the audit committee's role, rather than diminish it.

II. Enhancements To Auditor Independence And Audit Quality Make Mandatory Rotation Unnecessary.

The Sarbanes-Oxley Act also has brought about significant enhancements to auditor independence and audit quality, including fostering greater independence and improved audit quality through establishment of the PCAOB as an independent regulator of the public company audit profession. Since the Sarbanes-Oxley Act's passage, the U.S. Securities and Exchange Commission (the SEC) and the PCAOB have adopted a number of key measures aimed at further improving auditor independence.[1] The Concept Release acknowledges that these "significant reforms have enhanced auditor independence and, along with it, the reliability of financial

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[1] *See, e.g.*, SEC Final Rule, Strengthening the Commission's Requirements Regarding Auditor Independence, 68 Fed. Reg. 6006 (Feb. 5, 2003); and PCAOB Rule 3523, Tax Services for Persons in Financial Reporting Oversight Roles.

reporting."[2] In this regard, the Board has issued a number of significant auditing standards in recent years, the effects of which have not yet been assessed. These reforms include enhancements to the risk assessment standards that were adopted in 2010[3] and an engagement quality review standard adopted in 2009.[4] As Board Member Jay D. Hanson notes in his remarks accompanying the Concept Release, many of the Board's "new requirements bear directly or indirectly on auditor objectivity and professional skepticism, but their effects have not yet been reflected in audits [the Board has] inspected."[5] Accordingly, the Board should refrain from further considering as drastic a measure as mandatory audit firm rotation at this time.

III. The Monetary and Non-Monetary Costs of Mandatory Audit Firm Rotation Exceed Any Perceived Benefits.

As Board Member Daniel L. Goelzer stated in his remarks accompanying the Concept Release, "the Board should not impose the expense and burden associated with rotation on companies that raise capital in our markets unless the evidence is clear that the benefits will out-weigh the costs."[6] The need to assess the relative benefits and burdens of regulatory actions is particularly acute in light of recent instability in our financial markets and increasing global competition. In addition, the U.S. Court of Appeals for the District of Columbia Circuit's recent decision in *Business Roundtable v. U.S. Securities and Exchange Commission* stands as a strong reminder that regulators should rigorously evaluate a proposed rule's effect on efficiency, competition and capital formation, including through cost-benefit analysis, before proceeding with the rule's adoption.[7]

A. There Is Evidence that Mandatory Rotation Would Create Significant Potential For Deterioration In Audit Quality.

As the academic studies referenced in the Concept Release indicate, audit engagements "with short tenure are relatively riskier."[8] Consistent with these studies, we believe that a mandatory rotation requirement would create significant potential for deterioration in audit quality. Our companies believe that the risk of increased audit deficiencies would be

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[2] Concept Release on Auditor Independence and Audit Firm Rotation; Notice of Roundtable, PCAOB Release 2011-006 5 (Aug. 16, 2011) (the "Concept Release").

[3] Auditing Standards Related to the Auditor's Assessment of and Response to Risk and Related Amendments to PCAOB Standards, PCAOB Release No. 2010-004 (Aug. 5, 2010).

[4] Auditing Standard No. 7 – Engagement Quality Review and Conforming Amendment to the Board's Interim Quality Control Standards, PCAOB Release No. 2009-004 (July 28, 2009).

[5] Statement on Concept Release on Auditor Independence and Audit Firm Rotation by Jay D. Hanson, Board Member (Aug. 16, 2011).

[6] Statement on Concept Release on Auditor Independence and Audit Firm Rotation by Daniel L. Goelzer, Board Member (Aug. 16, 2011).

[7] *See* Business Roundtable v. SEC, 647 F.3d 1144 (D.C. Cir. 2011) (vacating the SEC's final proxy access rule because, among other reasons, the SEC "failed adequately to consider the rule's effect upon efficiency, competition, and capital formation").

[8] Concept Release at 16.

particularly acute in the initial years of an engagement when a new audit team – lacking knowledge of the company and its financial reporting – takes over the audit. In fact, the U.S. Government Accountability Office's 2003 report to Congress (GAO Report) found that 79% of major public accounting firms and Fortune 1000 companies "believe[d] that changing audit firms increases the risk of an audit failure in the early years of the audit as the new auditor acquires the necessary knowledge of the company's operations, systems, and financial reporting practices and therefore may fail to detect a material financial reporting issue."[9]

Particularly for large multi-national corporations like Business Roundtable companies, replacing the institutional knowledge and expertise of an existing auditor likely would take significant time. Half of the companies responding to our Survey believed that it would take *four or more years* following a change in auditor for the new firm to become sufficiently familiar with the company's operations and financial reporting practices to no longer require the additional audit resources often associated with a new public company client. As a result, during such period, audit quality could suffer. The threat to audit quality may be amplified for multi-national companies that become subject to mandatory audit firm rotation requirements in multiple jurisdictions, particularly if the requirements differ.[10]

Under a mandatory rotation requirement, audit quality also may be adversely impacted in the final years of an engagement. The GAO Report stated that approximately 59% of major public accounting firms "reported they would likely move their most knowledgeable and experienced audit staff as the end of the firm's tenure approached under mandatory audit firm rotation to attract or retain other clients, which they acknowledged would increase the risk of an audit failure."[11] In light of the risks posed to audit quality, we agree with the GAO Report's conclusion that "mandatory audit firm rotation may not be the most efficient way to strengthen auditor independence and improve audit quality."[12]

B. Mandatory Audit Firm Rotation Will Be Costly.

In addition to threatening audit quality, mandatory audit firm rotation would prove costly for companies and their shareholders. During the initial years of an engagement, these costs would include increased audit expenses and costs from disruptions to management and financial reporting staff. According to the GAO Report, Fortune 1000 companies estimated that auditor selection fees and additional auditor support costs would total at

9 U.S. GEN. ACCOUNTING OFFICE, GAO-04-216, PUBLIC ACCOUNTING FIRMS: REQUIRED STUDY ON THE POTENTIAL EFFECTS OF MANDATORY AUDIT FIRM ROTATION 6 (2003) (the "GAO Report").

10 See, for example, the European Commission's recent proposal relating to mandatory audit firm rotation. Press Release, "Restoring Confidence in Financial Statements: The European Commission Aims at a Higher Quality, Dynamic and Open Audit Market" (Nov. 30, 2011), *available at* http://europa.eu/rapid/pressReleasesAction.do?reference=IP/11/1480&format=HTML&aged=0&language=EN&guiLanguage=en.

11 *Id.*

12 *Id.* at 8.

least 17% of initial year audit fees.[13] Our Survey results show that additional resources may be required for five or more years in certain cases, as the audit firm develops sufficient knowledge of the company's business operations, internal controls and financial policies and procedures. Companies in our Survey that had changed auditors within the last ten years provided a range of cost estimates associated with the auditor change, from a low of $500,000 to a high of over $5 million. The significance of these costs is highlighted by Spain's experience with firm rotation; Spain abandoned mandatory rotation in 1995 in part due to concerns with training costs that could have resulted from changing the entire audit team.[14] South Korea further illustrates the costs of audit firm rotation. It adopted a mandatory firm rotation requirement in 2006, and research there has demonstrated that it resulted in increased audit hours and audit fees.[15]

Mandatory rotation would be especially difficult for large multi-national companies and companies operating in specialized industries, such as Business Roundtable companies. For multi-national companies, changing auditors is likely to prove exceedingly complex, as only a few audit firms have the necessary geographic reach to meet these companies' audit requirements. In addition to auditing consolidated financial statements, auditors of multi-national companies often perform statutory audits to meet local requirements in other countries. Our companies indicate that transferring all of these obligations to another audit firm on a periodic basis would be extraordinarily complicated. Companies in specialized industries also would face difficulties, as a replacement auditor may not have available expertise to meet the company's audit needs and educating the new audit team about the industry would take time. In certain cases, finding a suitable replacement firm simply may not be possible, as discussed below.

IV. Mandatory Audit Firm Rotation Is Not Feasible In Light Of Practical Considerations And Auditor Independence Rules.

As a practical matter, large public companies that operate globally choose their auditor from among the "Big Four" accounting firms because of shareholder expectations and the resources and expertise required to meet companies' audit needs. All Roundtable companies responding to the Survey currently engage one of the Big Four as their auditor. The Big Four, however, are not fungible. They are not equally represented in every country or market, and they have varying levels of expertise with respect to particular industries. And, in specialized industries, some companies are concerned about engaging a firm employed by their competitors.

The auditor independence rules create further difficulties for companies seeking a replacement auditor. Large companies often engage one or more of the Big Four accounting firms to provide prohibited non-audit services, such as tax or consulting services, often on a long-term basis. Most of the companies responding to our Survey reported that they engage at least three of the Big Four to provide non-audit services. For most of these companies, the total amount

[13] *Id.* at 6.

[14] *Id.* at 86.

[15] *See* Soo Young Kwon, Young Deok Lim & Roger Simnett, "Mandatory Audit Firm Rotation and Audit Quality: Evidence from the Korean Audit Market" (Nov. 2010), *available at* http://ssrn.com/abstract=1764343.

spent on these non-audit services exceeds $250,000 annually. It would not be practical, and may not even be possible, to unwind these arrangements in a fashion that would enable companies to replace their auditor in a timely manner. Companies responding to our Survey indicated that they would have “significant difficulty” in finding a replacement audit firm with an absence of independence issues, sufficient geographic presence and the necessary expertise.

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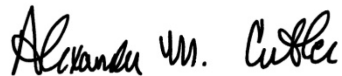
Thank you very much for considering our comments. We would be happy to discuss our concerns and recommendations, or any other matter that you believe would be helpful. Please contact Larry Burton, Executive Director of Business Roundtable, at 202-872-1260.

Sincerely,



Alexander M. Cutler
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AC/lb