financial executives international

COMMITTEE ON CORPORATE REPORTING

December 14, 2011

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

Re: PCAOB Rulemaking Docket Matter No.37

Dear Board:

The Committee on Corporate Reporting ("CCR") of Financial Executives International ("FEI") appreciates the opportunity to share its views on the Public Company Accounting Oversight Board's ("PCAOB" or "Board") Release No. 2011-006, "Concept Release on Auditor Independence and Audit Firm Rotation" ("the Release"). FEI is a leading international organization of senior financial executives. CCR is a technical committee of FEI, which reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations. This document represents the views of CCR and not necessarily the views of FEI or its members individually.

Although we support the Board's efforts to evaluate ways to enhance auditor independence, objectivity and professional skepticism, and improve overall audit quality, we oppose mandating audit firm rotation. We believe there is a lack of empirical evidence to support the Board's hypothesis that mandatory audit firm rotation will improve auditor independence, objectivity and professional skepticism, and that there are other ways to enhance these areas. Our opposition is primarily based upon the potential negative impacts to audit quality, especially around the time of a rotation, the anticipated increase in overall audit costs that will likely result from such a requirement, and operational challenges in connection with identifying successor auditors upon a rotation. We recommend that any changes to enhance auditor independence, objectivity and professional skepticism should potentially be part of a holistic approach that further enhances the role of the audit committee in overseeing the independent auditor. We are also concerned that mandatory audit firm rotation would lead to significant operational challenges due to the limited number of audit firms with the industry experience and international presence required to perform audits for large multi-national issuers. Lastly, we are concerned that mandatory audit firm rotation would be a drastic measure impacting hundreds of registrants to address concerns that appear to be arising in only a limited number of audit inspections.

Risks to Audit Quality

An audit firm accumulates knowledge of its audit client over an extended period of time. We believe there is a distinct and important difference between (i) the minimum level of knowledge of a company and its control environment that the auditor is required to obtain in order to conduct an audit in accordance with the standards of the PCAOB and (ii) the level and depth of such knowledge that is built and accumulated over time. Extensive experience

with a company drives an appreciation for historical transactions and trends as well as an understanding of an issuer's control environment. An audit firm develops a deep understanding of an issuer's accounting policies, procedures, processes and information systems through experience over time. As this knowledge base grows, the audit firm is far better able to challenge management's judgments and assumptions that underlie significant accounting estimates and other complex accounting and disclosure determinations.

An audit firm must climb a steep learning curve in the early years of an audit relationship with a new client, especially on large multi-national company audits where the audit work may be performed by several audit firm offices and/or member firms. It could easily take several years before an audit firm has developed a deep level of knowledge of the company. During these early years of the audit relationship, we are concerned that an auditor's lack of in-depth knowledge of the company and its history may adversely affect audit quality. The potential risks relate to new auditor's difficulty challenging management's assumptions and judgments due to the auditors' limited knowledge of the company, its history and industry. Although detection risk is inherent within the auditing model, a more mature relationship between the external audit firm and the company significantly mitigates the risk. The audit firm's specific experience with the company provides a greater foundation from which the auditor can assess the company's conclusions and to formulate their own professional judgments. Additionally, some academic studies suggest that auditors with longer tenure demonstrate increased audit quality, including the 2002 study by Geiger and Raghunandan (Geiger, Marshall A. and Raghunandan, Kannan, Auditor Tenure and Audit Reporting Failures, Auditing: A Journal of Practice & Theory, Vol. 21, No. 1, March 2002). Geiger and Raghunandan's analysis found that there was an adverse correlation between the propensity of audit failures and audit firm tenure, resulting in significantly more audit failures during the early stages of the audit relationship.

Specifically related to the notion that in some instances audit firms with a long-standing tenure could lack objectivity and professional skepticism, we believe the current five year rotation period imposed on the lead and concurring review audit partners adequately addresses these concerns. In our members' experiences, the engagement partners typically possess a broad understanding of the general business, industry specific and unique risks facing the company, and are the audit team members who maintain the closest relationships with the executive management of the company. However, our members see the greatest levels of in-depth knowledge of the company's policies, procedures and information systems reside with the experienced staff audit team members (e.g., managers, senior associates) as they perform the majority of the detailed audit procedures. We believe that the current mandatory rotation of the engagement partners coupled with the established company knowledge retained throughout the remainder of the audit engagement team allows for both a fresh perspective and depth of knowledge that is necessary to perform a high quality audit. In fact, we believe that longer audit tenure and mandatory partner rotations exemplify the combination of experience and independence necessary to achieve the desired level of objectivity and professional skepticism. Furthermore, there is no clear evidence that longer audit firm tenure adversely impacts an auditor's independent mindset and objectivity.

Increased Costs

We also believe that any mandatory audit firm rotation will likely result in increased audit costs. These increased costs will be both direct financial costs and indirect costs associated with lost time and productivity. The 2003 GAO study estimated an increase of 17% in audit fees as a result of a mandatory audit firm rotation requirement (Government Accountability Office, 2003, Required study on the potential effects of mandatory audit firm rotation). Our members' experience suggests audit firms currently absorb (i.e., do not bill to the client) much of the first-time non-recurring costs associated with a new audit engagement. We are

concerned that a mandatory firm rotation will change the marketplace dynamic such that more of these costs are billed to the audit client. We do not believe that it is in the best interest of the investors to burden them with these increased expenses without specific understanding of direct benefits from these costs.

We expect that companies will be significantly impacted by the lost productivity amongst various levels of a company's organization as a result of a mandatory audit firm rotation. Certain of our members have recently undertaken a voluntary change in audit firms and have directly experienced significant lost productivity as a result of the time necessary to educate the new audit firm's personnel on the company's background, control environment, accounting practices and information systems.

There also will be significant costs involved in changing the audit firm at various subsidiaries around the world where statutory audits are required. In most cases, our members seek to use the same audit firm that audits their consolidated financial statements to also perform any required statutory audit work in foreign subsidiaries. This is done for a variety of reasons, including managing the overall coordination and effectiveness of such arrangements as well as overall cost considerations. For many companies, this would mean not just a change in the auditor at the parent company level, but also the auditor at all such subsidiaries. We believe this introduces substantial additional costs into the audit process without a proven benefit to investors or the public interest.

Operational Challenges

We are also concerned that significant operational challenges will arise under a mandatory audit firm rotation requirement due to companies' limited options when selecting a successor audit firm. These limitations may arise due to concerns with certain geographic requirements, sufficient industry expertise and potential independence considerations.

Practically speaking, most of our members would need one of the Big 4 audit firms to perform the audit due to the overall size and complexity of the engagement. Further, the potential audit firms would need to have a deep understanding of and experience with their industry and have an international presence appropriate to meet the needs of the consolidated audit and various statutory audits. These complexities result in significant limitations to the population of potential audit firms who possess the size, international presence and overall expertise to meet the demands of our members' audit requirements.

With an already limited audit firm pool from which to choose due to size and industry expertise of the audit firm, we are also concerned with the impact that independence would have on mandatory audit firm rotation in regards to identifying a potential successor audit firm. Currently, most of our members use one of the Big 4 audit firms to perform the audit, while also utilizing one or more of the remaining Big 4 firms to perform non-audit services the auditor is prohibited from performing (i.e., valuation services or internal audit outsourcing). In these circumstances, our members' audit committee's could find themselves with very few, if any, options that would not also involve changing a non-audit service provider. If audit firm rotation were required, many of our members would undoubtedly find themselves in a situation where they would have to rotate a Big 4 firm out of the non-audit services space in order to establish their independence and thus eligibility to perform the audit. This rotation must be completed well before the time of mandatory rotation, which would further constrain and complicate the selection process of the new audit firm as well as cause a significant disruption to management's processes as some of these services could take a significant period of time themselves to transition and likely result in increased costs.

The pervasiveness of these limitations would be a significant hurdle that all large, international issuers would be forced to address. The compounded nature of these limitations realistically reduces the number of audit firms who could adequately perform the audit, while causing an unnecessary disruption to management's processes.

Audit Committee Corporate Governance

We are concerned that mandatory audit firm rotation will preclude audit committees from effectively fulfilling one of their chief governance responsibilities. Currently, audit committees select the audit firm that they believe best meets the company's and investors needs. Further, audit committees have the right to implement a change in audit firms at any time and have exercised this right when they considered it appropriate to do so. We believe that the audit committee is in the best position to determine who will perform the audit and when it is appropriate to make a change in audit firms and that mandatory audit firm rotation significantly impedes the exercise of this discretion. For example, an audit committee may be forced to make a decision which is not in the best interests of investors by having to change audit firms in the middle of a complex business development transaction, registration statement or spin-off which could delay the transaction and put investors at greater risk.

Other Actions to Consider

With respect to the Board's initiatives regarding the enhancement of audit quality, we believe that there are other potential solutions that could achieve the desired goals without mandating an audit firm rotation model. These include the expanded distribution of inspection comments to the issuer's audit committee and more timely distribution of formal PCAOB inspection results.

The audit committee's oversight role directly includes the responsibility to oversee the overall quality of the audit and audit firm including assessing independence, objectivity and professional skepticism. To further improve this aspect of audit committee governance, a natural first step would be to enhance the information available to the audit committee for use in their assessment of the audit firm. While we recognize there may be limitations under the laws and regulations that exist today, one alternative solution is for the PCAOB to revise the auditor's required communications with the audit committee to include its firm's inspection results, including, where applicable, any audit engagement-specific results. We believe audit committees are generally effective in their oversight of the audit firms and believe that this additional knowledge, specifically related to the effectiveness of their audit firm and team, would allow audit committees to more proactively address any potential audit quality concerns. Ultimately, it is in our best interest and the interest of investors to promote full and effective communication between audit committees and audit firms, and this information would be useful in the audit committee's ongoing assessment of the audit firm's effectiveness. We also recommend that the PCAOB consider enhancements to the auditor's required communications to the audit committee that address additional matters specifically related to the audit firm's objectivity and professional skepticism exercised throughout the audit.

While the PCAOB has made progress in issuing their inspection reports more rapidly following the completion of inspection fieldwork, we encourage the PCAOB to continue to refine its reporting process so that inspection reports could be issued sooner after completion of fieldwork. For example, a recent inspection report for an annually inspected firm was issued in November 2011 following completion of fieldwork in November 2010, under which the covered audits were presumably for fiscal 2009 year-ends. We believe that a more timely delivery of the Board's inspection results to auditors and the investing public

following completion of fieldwork could provide important information to audit committees and further enhance ongoing efforts to increase audit quality.

In summary, we do not support a mandatory audit firm rotation requirement and believe the PCAOB should continue its research into other potential initiatives to improve auditor independence, objectivity and professional skepticism and, ultimately, audit quality.

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We appreciate the Board's consideration of these matters and welcome the opportunity to discuss any and all related matters. If you have any questions, please contact Lorraine Malonza at (973) 765-1047 or lmalonza@financialexecutives.org.

Sincerely,

Loretta V. Cangialosi
Chair, Committee on Corporate Reporting
Financial Executives International

cc: Martin F. Baumann, Chief Auditor and Director of Professional Standards