STATE BOARD OF ADMINISTRATION OF FLORIDA

1801 HERMITAGE BOULEVARD
TALLAHASSEE, FLORIDA 32308
(850) 488-4406

POST OFFICE BOX 13300
32317-3300

December 15, 2011

Mr. J. Gordon Seymour
Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006-2803
Via email: comments@pcaobus.org

RE: PCAOB Concept Release on Auditor Independence and Audit Firm Rotation
Release No. 2011-006 Rulemaking Docket Matter No. 37

Dear Secretary Seymour:

The State Board of Administration of Florida (the SBA) welcomes the opportunity to provide comments to the Public Company Accounting Oversight Board (PCAOB) regarding its 2011 Concept Release on Auditor Independence and Audit Firm Rotation. The SBA manages the assets of the Florida Retirement System, the fourth largest public pension plan in the United States with 1.1 million beneficiaries and retirees. The SBA's governance philosophy encourages companies to adhere to responsible and transparent practices that correspond with increasing shareowner value.

The SBA supports the PCAOB's efforts to assess and inspect the effectiveness of current audit practices. European regulators are also currently reviewing the statutory audit of public-interest entities and the quality of financial audits. In light of the recent financial crisis, all market participants should be encouraged to continuously monitor risk and promote market stability.

SBA staff agrees that auditor rotation should be considered by issuers as an avenue to increase auditor independence, but does not support a prescriptive, mandatory auditor rotation requirement.

With the enactment of the Sarbanes-Oxley Act, several provisions have been implemented to promote auditor independence. An audit committee selects and oversees the auditor and all their activities. Auditors may no longer provide certain non-audit services and audit partners that serve on engagement are now subject to mandatory rotation. A recent study by Audit Analytics found that during the six years since the implementation of the Sarbanes-Oxley Act, quantitative data concerning restatements and late filings (NT disclosures) reflect a steady and substantial improvement in financial reporting.[1] With the same thrust, auditor rotation should address any concerns of potential conflicts of interest between an auditor and an issuer, such as pressure to maintain current client revenues or to overlook aggressive accounting practices.

While SBA staff believes that audit firm rotation has the potential to improve audit quality and reduce costs, a well designed oversight process is also important. The SBA has hired audit firms who, to our satisfaction, have demonstrated expertise in our line of business. The SBA's auditors also present to our Audit Committee their detailed annual audit plan for approval. The SBA utilizes the services of several major audit firms in the audit of the financial statements of its numerous funds, wholly-owned entities and joint ventures. It has been our experience

[1] Whalen, Don and Mark Cheffers, "Auditor Tenure, Financial Officer Turnover, and Financial Reporting Trends," Audit Analytics, December 2011.

that on occasions where we rotated audit firms, the SBA has been able to switch among different accounting firms and, in the process, reduce costs to our beneficiaries and retirees.

Therefore, SBA staff does not believe that auditor rotation should be prescribed and mandated at this time. Alternatively, issuers could review their audit relationships on a given year and share with investors their decision to either change audit firms or maintain their current relationship. European regulators require companies to put their audits out to tender at least once every 10 years or explain to investors why they have not done so. It has been suggested that the audit committee report the specific reasons why the decision to appoint or reappoint the company's auditors was made. This method of disclosure and transparency would allow investors to make their own decision as to the company's relationship with its auditor. Therefore, SBA staff believes the audit committee should consider the appropriateness of limiting the number of consecutive years for which one firm may serve as the company's outside auditor and disclose the rationale for its decision.

SBA staff agrees that auditor rotation could increase costs in the initial year of a change, but disagrees that financial cost should be the deciding factor in whether or not a company should change auditors.

Audit Analytics found that over 16 percent of large companies (those included in the Russell 1000 stock index) have engaged the same auditor for 40 or more years compared to only 4 percent for small companies (those within the Russell 2000 stock index). SBA staff is mindful of the fact that any new audit firm will require time to get 'up to speed' and, according to a recent study, is likely to involve additional time requirements and cost.[2] Since no two companies are identical, each will require an auditor with certain expertise and experience for their industry and business model and, therefore, may have a limited pool of auditors to choose from that meet its specific needs. However, SBA staff believes that the benefits of an independent and objective audit far out-weighs any time and financial costs that may be associated with auditor rotation. Auditor rotation may be warranted if a company, through the board's audit committee, feels that a new auditor will approach the engagement with a fresh perspective, as opposed to simply replicating procedures performed in prior year's work papers, and is therefore expected to improve audit quality.

SBA staff believes that the PCAOB would be correct to conduct a pilot program before a mandate is enacted.

Due to the lack of relevant empirical data on the costs and benefits of mandatory audit rotation, we support additional research on this topic and support the proposal to have the PCAOB conduct a pilot program of registered public accounting firms so that auditor rotation could be further studied before any mandatory regulation is imposed.

Thank you for your consideration and for the PCAOB's ongoing efforts to improve audit quality. If you have any questions, please contact Michael McCauley, Senior Officer—Investment Programs and Governance, at (850) 413-1252, or governance@sbafla.com.

Sincerely,

Ashbel C. Williams
Executive Director & CIO

cc: Governor Rick Scott, as Chairman of the SBA
Chief Financial Officer Jeff Atwater, as Treasurer of the SBA
Attorney General Pam Bondi, as Secretary of the SBA

[2] U.S. General Accounting Office (GAO), "Required Study on the Potential Effects of Mandatory Audit Firm Rotation 8," (2003). Study showed larger firms' estimated audit costs would increase by more than 20 percent during the initial year after a change in external audit firm.