Gary R. Kabureck
Vice President; Chief
Accounting Officer

Xerox Corporation
45 Glover Avenue
Norwalk, CT 06856

6ary.Kabureck@xerox.com
tel 203.849.2630

January 30, 2012

Mr. J. Gordon Seymour
Secretary, Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC. 20006-2803

PCAOB Rule Making Docket Matter No. 037 – Concept Release on Auditor Independence and Audit Firm Rotation

Dear Sirs:

In my capacity as a member of the Standing Advisory Group (SAG) and as the Chief Accounting Officer of Xerox Corporation I am pleased to have the opportunity to provide my comments and suggestions on the PCAOB's recent Concept Release "Auditor Independence and Audit Firm Rotation" (Release No. 2011-006). Xerox Corporation is a multinational organization with operations in 160 countries and annual revenues of approximately $23 billion. Our audit fees, exclusive of non-recurring items and non audit services, have approximated $20 million in recent years. We fully support the PCAOB's stated objectives for this Concept Release of strengthening auditor independence, objectivity and skepticism. These principles have long formed the basis of modern auditing and financial reporting and are critical to ensuring the integrity of an independent audit. However we at Xerox strongly disagree with any final rule making which will require the mandatory rotation of a company's auditors. We believe such a requirement will not result in improved auditor independence, objectivity or skepticism and there are numerous cost-beneficial ways, far short of auditor rotation, that can enhance achievement of these objectives. The PCAOB's own research and the research of others does not make a compelling case in support of mandatory auditor rotation. Further we note the Concept Release itself acknowledges that there are important company and investor benefits to long term audit relationships. Lastly, mandatory auditor rotation usurps a responsibility of a company's audit committee and will result in unnecessary costs and business disruptions. This letter will conclude with several suggestions on other means to potentially enhance auditor independence, objectivity and skepticism

My detailed comments and recommendations follow:

Recent Enhancements to Auditing Standards Make Mandatory Auditor Rotation Unnecessary

The Sarbanes-Oxley Act has already resulted in significant enhancements to auditor independence and overall audit quality. The creation of the PCAOB with its audit firm registration process, deep inspection program and effective enforcement activities by itself represents a significant improvement from previous practice. As impressive as the PCAOB's activities and accomplishments have been to date, it is worth noting your organization is relatively young and the full positive impact of PCAOB activities is most likely still emerging.

Early in the PCAOB's existence the managerial reporting and external auditing on the effectiveness of internal controls over financial reporting (ICFR) became a reality for most corporations beginning in 2004. The positive impacts of ICFR are unmistakable. As reported in the Audit Analytics December 2011 report "Auditor Tenure, Financial Officer Turnover and Financial Reporting Trends" during the 6 years ended in 2010 material weaknesses in the Russell 1000 companies steadily dropped from 8.2% of companies in 2005 to 0.8% in 2010. Likewise for the same study group, in 2005 131 of the Russell 1000 companies reported restatements however that number had declined to 31 by 2010. Similar results are observed when the Russell 2000 companies results are included. The conclusion is that for 12,000 audits over the research period restatements and material weaknesses have steadily improved which must indicate that overall financial statement reliability has been improving.

In 2010 the PCAOB issued several new auditing standards on assessing engagement audit risk and, in 2009, a major standard expanding the role of the engagement quality reviewer (the 'EQR' or as more commonly known the concurring partner). Additionally, at this time there exists several important standards development projects which, when finalized, will undoubtedly increase auditor independence, objectivity and overall audit quality. These projects include the auditor's reporting model and auditor communications with audit committees among others.

One of the often expressed concerns about auditor independence (or lack thereof) is (was) the temptation for audit firms to actively solicit non audit services from audit clients such that the auditor may have become so financially dependent on non-audit fees, so much so that that audit independence, objectivity and skepticism were compromised. This important concern was also addressed by the PCAOB and SEC several years ago when nine (9) prohibited services by a company's auditor were enumerated. These significant restrictions on allowable non audit services has gone a long ways towards addressing the ability of auditing firms to become financially dependent on non-audit fees from audit clients. Proxy statement disclosures of fees paid to auditors is extensively studied and widely reported on. It is very apparent that

over the last decade non audit services provided to audit clients has been severely curtailed. In addition, many companies have adopted governance policies limiting non audit services to de-minimus amounts.

Lastly, we believe the current five year rotation requirement for the lead audit partner and the EQR effectively results in a 'fresh look' at the audit client every few years. In addition, for larger accounts the major audit firms have a practice of having a second headquarters audit partner assigned adding another check and balance on the lead audit partner. In comparison to earlier rules, after rotating off it is much more difficult for the lead audit partner to re-engage in the near term with his or her former audit client. The net result is that today a process is in place to continually ensure partner level transitions which can and does increase overall auditor objectivity and skepticism.

In light of all these impressive accomplishments – the benefits of some are just emerging - I recommend the Board refrain from the drastic step of mandatory auditor rotation until substantial evidence is available that conclusively establishes the aforementioned are materially ineffective.

Mandatory Auditor Rotation will Increase Risks to Audit Quality

While the stated objectives of this Concept Release are to enhance auditor objectivity, independence and skepticism these objectives represent tactical goals in support of the Board's overarching objective which is to improve overall audit quality. We believe that mandatory rotation of auditing firms will most likely result in lower – not higher – overall audit quality.

Institutional knowledge is a valuable asset – one that is not capable of being sold or transferred from one entity to another. It is obtained the old fashioned way – by the sustained hard work of many professionals over a long period of time. One of the primary reasons a company, or more importantly its audit committee, values long term audit relationships is this institutional knowledge as it enables the auditor to bring the proper resources to the audit at the right place and time. Learning curves are steep and costly. The Concept Release itself notes that most audit failures occur early in a new auditor's tenure. There is a big difference between a new auditor having the minimum knowledge of a company and its control environment required to conduct an audit in accordance with the standards of the PCAOB and an effective audit which is planned and executed by an incumbent auditor with full knowledge of the company, its financial processes, culture, business objectives, etc.

With respect to transitioning institutional knowledge, there is an enormous difference between a lead partner or engagement team within a firm transitioning audit knowledge to another audit partner in the firm versus the information that is required to be communicate between predecessor and successor audits under

current standards. It seems very logical that within a firm there will be an orderly and effective transition policy and protocol versus what may expected between different audit firms. We believe the current practices of mandatory partner rotation, EQR reviews and National Office reviews and consultations are sufficient to preserve auditor independence, objectivity and skepticism. If, despite many objections to the contrary, the Board decides to require mandatory auditor rotation, as a prerequisite the Board will need to vet new standards with respect to required communications and transitional support between predecessor and successor auditors.

Audit services for multinational corporations can rarely be meet other than a Big 4 firm. It is important to note that the Big 4 are not fungible. They each have varying strengths (and weaknesses) in terms of geographic reach, industry expertise, local presence, etc. It is possible in a given industry that only 2 of the Big 4 have the relevant firm wide expertise. In this scenario the situation would effectively result in a duopoly and industry participants would merely rotate back and forth between 2 firms. Does this accomplish much?

One last point on audit quality and risk, while most observers seem to agree the risk of audit failure is highest in the early years of a new auditor's tenure, I submit there is an equal risk of audit failure late in the auditor's tenure as well because the existing audit firm can naturally be expected to move its best people assigned to the audit to other clients of the firm.

Appointment and Removal of Auditors is Properly an Audit Committee Responsibility

Under Section 301 of the Sarbanes-Oxley Act, the audit committee of a public company is responsible for managing the relationship with the company's independent auditor including appointment, compensation, retention and oversight. Mandating auditor rotation would circumvent this external director governance responsibility and compromise the audit committee's ability to effectively engage, oversee and terminate an audit firm. For U.S. public companies, all audit committee members must be independent directors who are knowledgeable about a company's business, internal controls, financial policies and external reporting requirements. Because of this unique role, we believe a company's audit committee is best positioned to determine the circumstances under which an incumbent audit firm should be replaced. It is important that an effective working relationship exists between a company's audit firm and the audit committee; the requirement for periodic rotation is inconsistent with this objective. Audit committees do have the right to terminate an audit relationship at any time deemed appropriate and, as is public record, it is not infrequent that this right is exercised. When an audit termination occurs, SEC has Form 8-K disclosure requirements requiring both the company and the terminated firm to report on the circumstances of the dismissal.

Assuming the PCAOB persists, despite the strong objections of many commentators, to require mandatory auditor rotation there will inevitably be many instances where a change in auditors compelled by regulation would not be in the interest of the company or its investors and such a change would not be otherwise contemplated. For example, a very complex M&A transaction, a major business re-organization or transformation, a material capital markets action, etc. may span several quarters and be in process over a fiscal year end when there is a change in the external audit firm before the event in question is finalized. This will create significant challenges for, and between, management, the predecessor auditor and the successor auditor and require complicated and otherwise unnecessary coordination of activities. The list of potential complications is long but includes the obtaining of consents, subsequent events reviews by the predecessor auditor, carrying forward prior year audit reports on earlier year but still live financial statements, concurrence between the two auditing firms on all material matters of accounting and auditing significance, etc. We strongly encourage the Board to field test and evaluate the real world implications of requiring the rotation of audit firms at sub optimal times and the difficult position audit committee members will find themselves in these circumstances.

Mandatory Auditor Rotation will Permanently Increase Costs and Result in Unnecessary Business Disruption without Commensurate Benefits

Virtually all comment letters have noted the significant increase in audit costs that mandatory auditor rotation will cause. We agree with those observation and would like to offer some additional perspectives which have not been as frequently raised in the comment letters to date:

Monetary amounts aside, the PCAOB needs to address the question, and concern, as to exactly how the audit firms will source the increased workload? I have been on both sides of changing auditors both as an auditor and as a preparer. Many commenters have observed that it is at least four (4) years into a new audit engagement before the audit effort settles into its ongoing level. Consider this plausible scenario: In year 1 of a new audit there is a 50% increase in assigned hours over the steady state; in year two - 30% and year 3 - 10% before year 4 achieves normal go forward level of efforts. Extrapolating this using the European Union proposal of a 6 year rotation plan, there is a 15% permanent increase in audit hours so presumably on average each auditing firm will need 15% more staff. Extrapolating using a 10 year rotation plan results in 9% permanent increase in staffing requirements. With respect to the demand for accounting skills, every analysis I have seen indicates that the demand for accounting talent will grow by ~5% or more for the foreseeable future. So, the obvious question in need of an answer is 'where will all these future accountants come from?'

There will be significant burdens and hidden costs with respect to the rotational selection process itself – on management, the audit committee and the audit firms. The process for changing auditors, similar to the process for changing other major vendors, would commonly use an RFP process. Due diligence materials would need to be prepared; interviews with prospective auditors would need to occur; the audit firms would need to consider their bids and identify the engagement partner and senior audit team. For a multinational corporation the size of Xerox this process would be lengthy - the mere task of visiting numerous global locations and obtaining an understanding of accounting processes and internal control effectiveness would be immense and expensive. Senior management and the audit committee would need to divert significant time to reviewing and assessing competing bids and final interviews. After the new firm was selected, there would then need to be a major coordinating effort between the predecessor and successor firms. The company's internal accounting and other finance organizations would see an exponential increase in staff time to adopt to a new auditing firm and to familiarize the new auditors with the company. All of this unnecessarily drives up operating costs and diverts important managerial and outside director time for no commensurate benefit.

For virtually all major corporations, realistically only the Big 4 firms can perform the audit. Xerox, like most major companies, routinely utilizes the consulting and other non-audit services capabilities of the remaining Big 4 firms. Many of these services would constitute prohibited services if performed by our external auditors. Further, even if not an expressly prohibited service, many companies from time to time will use these same firms to perform other non-audit and consulting services which current governance practices would tend not to award to a company's audit firm. The Big 4 firms have immense global presence and vast business support capabilities. Mandatory audit rotation would be a disservice to investors because one of the practical implications is that the at least some non-audit service capabilities of the other Big 4 firms would no longer be available to companies.

Multinational companies globally operate through subsidiaries most of which will have statutory audit requirements. It is not uncommon for corporations the size of Xerox to have hundreds of statutory audit reports each year. For purposes of the US GAAP and GAAS audit only a handful would typically be significant with the remainder being primarily local compliance efforts. Many companies have a policy of requiring all statutory audits to be performed by the parent company's auditor. In order to minimize business disruption, companies would have to choose – leave the local incumbent statutory auditors in place when the parent company rotates the incumbent Big 4 auditor or transition dozens to hundreds of local audits to the new Big 4 firm which may not otherwise be necessary to enable the US GAAP and GAAS audit. As the PCAOB deliberates the notion of mandatory auditor rotation the implications on statutory audits should not be underestimated.

Evidence in Support of Mandatory Auditor Rotation is Neither Sufficient nor Compelling

The Concept Release accurately notes that the issue about mandatory auditor rotation has been around for a long time and I agree it is time to conclusively address the subject and (presumably) conclude the costs and risks far outweigh the benefits. Many comment letters have noted the conclusion of the 2003 GAO Report, commissioned as part of the Sarbanes-Oxley Act, to study and report on the potential effects of requiring mandatory audit firm rotation. The conclusion, as you are aware, states that "mandatory audit firm rotation may not be the most efficient way to enhance auditor independence and audit quality."

It does not appear staff or other independent research to date has established a definitive correlation between audit failures and the length of the audit relationship. It is important to observe that the Board defines audit failures as situations where documented audit evidence is either insufficient, or categorically does not, provide the proper support the audit report. Financial statement users on the other hand would likely define audit failures in terms of restatements which, as discussed on page 2 of this letter, are infrequent and declining. It is critical for this project to reconcile these two very different theories.

I recommend that staff research on the incident rates of audit failures be conducted to categorize the nature of audit failures by: auditor competence and training, lack of industry expertise; occurring in the early years of a new audit relationship; audit firm size no longer adequate for a growing client; and lastly by lack of auditor independence, objectivity or skepticism. Lastly, this research should not be limited to audits supervised by the PCAOB – it is only in the last year that the PCAOB (as part of the Dodd Frank Act) achieved control over the audits of broker-dealers and as we all know too well some of the most spectacular audit failures in recent years (e.g. Madoff Securities) involved audits not subject to the PCAOB's procedures.

Potential Strategies for Enhancing Auditor Independence, Objectivity and Skepticism

The considerable Board and staff effort which would be required to attempt finalizing a rule requiring mandatory auditor rotation would be far better used in developing new auditing standards and other policy positions consistent with the Concept Release's primary objective of enhancing auditor independence, objectivity and skepticism. I believe considerable progress can be made towards the objective in a much more cost-beneficial and practical manner than the draconian step of requiring mandatory auditor rotation. I have listed below a number of suggestions for your consideration:

- The PCAOB should refine its inspection process such that its firm inspection reports are issued more timely. For example, in November of 2011 an inspection report of a major firm was issued for field work completed in November 2010 for the calendar year 2009 audits. Using this example, by the time the year end 2011 audits are completed, fully 40% of the engagement partners from the 2009 audits will have rotated off the engagement diminishing the effectiveness of the inspection findings. A more timely delivery of inspection results to the investing public would be beneficial.
- PCAOB inspection reports for the specific engagements reviewed should be made available to the audit committees of the companies audited. Many comment letters have recommended this. Transparency is always key to effectiveness as the 'light of day' (or the potential therefore) tends to bring out the best in people – in this case an audit engagement partner would clearly not want it to be communicated to his or her client that the PCAOB had concerns with how the engagement was conducted. We want to second the comment letters from many audit committee members who have also recommended these reports be made available because an inspection report would be invaluable to the audit committee's oversight of the audit function.
- Several professional groups I am associated with have discussed the merits of revising audit committee membership requirements to include a 'financial accounting' or' financial auditing' expert – which is a different skill set from today's required 'financial expert'. This letter is not advocating this becomes a requirement but merely that the subject is worthy of PCAOB and SEC staff research.
- At several SAG meetings we have discussed 'audit quality indicators' – what they are, how they would be measured and how they would be used. To my knowledge no consequential further actions have to date occurred. I recommend this become a formal staff project and when finalized they become a part of the PCAOB inspection procedures and, to the extent any inspection report is engagement specific, it be shared with the related audit committee.
- Finalize the current major PCAOB projects on revising the auditor's reporting model and required communications with audit committees and allow sufficient time for these standards to be in force and then measure their effectiveness. While many commenters, including as you will recall myself, disagreed with many of the more expansive requirements of these proposals I anticipate that both projects will be completed with at least some modification from current requirements. These should be allowed reasonable time to work in practice and their effectiveness evaluated.
- Finalize the requirement to publicly disclose the name of the lead engagement partner – either by a personal signature on the audit report or by other disclosure means. This issue has been discussed many times at SAG and other PCAOB forums and is a common practice outside the

United States. Publicly personalizing the engagement partner's name with the audit report and related annual report can only serve to increase the engagement partner's focus on the quality of the audit.

Summary

We strongly disagree with any notion of requiring mandatory audit firm rotation no matter what the rotational interval may be. Such a requirement holds a very real possibility for an overall decrease in audit quality and will result in a permanent increase in cost and business complexity that is not justified by the evidence at hand. As discussed, the numerous PCAOB and SEC pronouncements and regulations of recent years are having a positive effect on external reporting casting further doubt on the need to mandate auditor rotation. We remain very supportive of the Board's efforts to continue enhancing auditor independence, objectivity and skepticism by less draconian, more cost effective means and, as we have in the past, are prepared to provide the Board whatever assistance we can.

* * * * *

Thank you for the opportunity to provide these comments for your consideration on this important project. Please do not hesitate to contact me if you have any questions or comments about the contents of this letter.

Yours very truly,

Gary R. Kabureck

c: M. Baumann, Chief Auditor and Director of Professional Standards, PCAOB