From:	Pat
To:	Comments
Subject:	auditor rotation
Date:	Monday, July 16, 2012 4:10:03 PM

Dear Sirs:
As one who has both worked for and audited publicly traded companies, I am highly in favor of auditor rotation. In fact, I believe it should be mandatory for any entity that has an audit requirement, including state and local governmental entities, nonprofits receiving grant funds, and small business meeting debt covenant requirements.

It has been my experience that the continuing firms miss things purely due to the familiarity or because they are afraid of making the client angry. That is at a minimum an independence issue.

Issues that were overlooked in prior audits are missed again and again. Fresh eyes and perspectives could certainly eliminate some of that.

During my first audit, I found a number of related party transactions in a governmental entity, while performing tests of controls. The partner did not want to put those issues in a management letter. The partner asked over and over again how I knew that it was in issue. Well, I learned about related party transactions in intermediate accounting and learned in auditing that they had to be disclosed. It was a long time before I had enough nerve to ask him why he had not addressed it and did he consider the implications related to independence.

When I found violations of federal and state laws during the performance of a local school district audit, again the partner did not want to put the violations in a management letter. That school district is being investigated now. This could have been avoided had the audit partner taken the appropriate stand. But he did not want to make the client angry.

During my tenure with a national firm, I was asked to go to a client and review the work of the former controller after he resigned. The new controller found $1,600,000 in unrecorded liabilities stuffed in a bottom drawer. The former controller had been an audit manager for the national firm, resigned to take the position of controller, but still managed a green grad through completion of the audit. The former manager, now controller, told the green grad that the entity was a cash basis entity. The green grad did not perform a search of unrecorded liabilities as a part of the field work. Well, it is not possible to be cash basis when you have inventory and accounts receivable. More than $1,000,000 was for inventory purchases made in December that were debited directly from the checking account in January. The national firm had audited the company for more than 10 years.

I followed green grads on an international audit where the financial statements were materially misstated and no one caught the really small issue in over 30 years. The national firm had done the audit since inception. No manager or partner caught the mistake. It was such a simple thing, it was embarrassing. Even when I corrected the current year and made the corrections to the prior year financial statements, both the manager and managing partner did not understand. I had to explain the very simple premise all the way to Chicago.

As certified public accountants, we should never stop thinking. We should always, always question. We should not just do it the way it was done last year and the previous 30 years. And we should certainly not be afraid to make the client angry. Surely there are ways we can persuade the client to come on board with us. Or we should withdraw.

When we do the same work for more than five years, we stop being objective. We see what we want to see to finish within budget or what the manager sees to avoid a difficult management letter comment.

Auditor rotation would eliminate a portion of this. I also believe that once a person, regardless of educational and professional experience has worked on a particular audit, they should NEVER be permitted to work on that client again. Certainly, you can understand that if I work for KPMG on a particular audit, PWC should not recruit me so I can work on the same audit client. The same issues will exist. AND former employees of the audit client should NEVER be hired to work on the audit.

I felt this way when the then Peat Marwick was auditing the publicly traded company I worked for 30 years ago. Even as a green grad, I saw the issues. The same firm audited the same company for more than 40 years and did not see the fraud that was obvious to me in the first few months I was employed there. Even when my auditing professor encouraged me to tell Peat what I saw and accompanied me to a meeting with them, they blew it off. When the company sold later the same year, the buyer found that there was more than $25,000,000 in fraud on the balance sheet. I was so embarrassed. Peat Marwick and the successor auditor missed what was glaringly obvious. So much for due diligence.

I do not hold myself out as an expert on anything. However, I have decades of auditing experience. I have followed many a seasoned auditor and found mistakes that were material to the financial statements and fraud. The predecessor was too familiar with the client. The predecessor was afraid of losing the client. The predecessor was too busy to effectively supervise and review field work.

I think that if I know another audit firm will succeed me in 5 years that I will do a more thorough job. I will be more careful, more objective, more independent. I don't want to embarrass myself before my profession.

I realize many of my colleagues would gladly shoot me for saying this, but it is my professional opinion. Auditor rotation should and must be mandatory. Without it, there is no independence, objectivity, or reliability in financial statements. We must do something, everything possible, to gain back the public trust.

Thank you for asking for comments. I have wanted to say these things for decades.

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