Public Company Accounting Oversight Board
Public Meeting on Auditor Independence and Audit Firm Rotation
Statement of Charles M. Allen
Chief Executive Officer
Crowe Horwath LLP
March 22, 2012

Introduction

Crowe Horwath LLP (Crowe) is a large national firm and an independent member of the Crowe Horwath International network. Our firm has over 2,500 people and 270 partners. Our audit practice focuses on substantial middle market companies, as well as smaller organizations. We serve many public companies, many sizable and complex companies with private ownership structures ranging from private equity groups to owner-managed businesses, and a wide range of public interest organizations. We are inspected annually by the Public Company Accounting Oversight Board (PCAOB). We are actively engaged in industry-wide activities designed to improve audit quality. It is important work.

Chuck Allen, our Chief Executive Officer, also serves as co-vice chairman of the Governing Board of the Center for Audit Quality. These remarks represent the views of Crowe Horwath LLP, and not those of any other organization.

Prior to becoming CEO, Mr. Allen was a signing audit partner and led our commercial audit practice, so he has a full appreciation for the issues at hand. We submitted a comment letter in response to the PCAOB's concept release on auditor independence and audit firm rotation and appreciate being invited to participate in these important roundtables.

Alternatives to Mandatory Firm Rotation

It is no secret that many are strongly opposed to mandatory firm rotation. In response to those views, Chairman Doty has asked, "if not mandatory firm rotation, then what else can be done to enhance independence, objectivity and skepticism?" We would like to share two important processes in place at Crowe which are specifically designed to strengthen independence, objectivity, and skepticism.

The pressures on objectivity and skepticism are primarily on the engagement partner. To further mitigate those risks, we have an additional review beyond those provided by the engagement partner and the engagement quality reviewer. For every public company audit, our national office reviews the draft financial statements, draft filings with the Securities and Exchange Commission (SEC) or other regulator, and documentation of consultations and significant audit conclusions looking for potential sources of significant accounting or auditing errors. The national office reviewer is required to “sign off” prior to the issuance of the financial statements and the filings with the SEC or other regulator. These national office reviewers look at many engagements across our firm, and therefore have a different perspective than both the engagement partner and engagement quality reviewer. As a result, the significant engagement decisions are subject to this additional review, not just the one performed by the engagement quality reviewer. This process adds an additional layer of objectivity and skepticism to each engagement.

Secondly, our long-standing partner compensation model significantly reduces the concern our partners might have about losing a client. Our model has no direct linkage of client retention, size of book of business, or sales activity to an individual’s compensation. Rather our income and share ownership is anchored in a concept of equally sharing changes in the firm’s income and equity. This is a strong incentive to preserve each partner’s objectivity and skepticism.

These two processes, both of which are simple and straightforward, serve to lessen the pressures on the engagement partner and provide an environment for objective and skeptical decision making.

Risks of Audit Failure

We spend a significant amount of time managing risks to our firm. In our profession, avoiding a major audit failure is front and center in such considerations. We truly do not worry about our partners failing to properly confront tough issues because they have lost their objectivity or skepticism. We do, however, worry about the potential for failure from other directions.

Upon reflection on the root cause of failures, we find they are principally due to companies taking risks that they cannot appropriately manage. Complex transactions are now found in every size of entity. This risk is particularly acute in the companies of the size and nature we audit, as they are continually challenged to devote the necessary resources to very complex accounting requirements.

The PCAOB currently has a project on its agenda which can make important headway in this area – the project on the auditor’s report. We believe an appropriately designed reporting structure using the emphasis of a material matter model would enable the auditor to point to the most significant matters.

If the PCAOB were to proceed with such a recommendation, we believe the result will be an auditor’s report which illuminates key risks, including complicated accounting matters, for clear understanding for investors and other stakeholders. Such reporting would provide transparency of the auditor’s objectivity, providing deeper insight into their thinking.

Preserving the Role of the Audit Committee

Audit committees have an essential role in corporate governance. The audit committee oversees the financial reporting process, the effectiveness of internal control over financial reporting, and the performance and independence of the independent auditor. The audit committee represents the interests of investors in the entity as well as other stakeholders by selecting and overseeing the most appropriate independent auditor for the entity. Mandatory firm rotation would undermine the role of the audit committee and unnecessarily restrict the choice of audit firms available to the audit committee.

The Sarbanes Oxley Act of 2002 (SOX) put in place many enhancements to the audit committee's role including requiring each member of audit committee to be independent, requiring the audit committee to pre-approve any non-audit services, such as tax services, requiring disclosure whether at least one member of the audit committee is a financial expert and requiring the audit committee to be directly responsible for the appointment, compensation, and oversight of the auditor. As a result of these and other enhancements, we have observed a substantial increase in audit committee engagement since the passage of SOX.

Regulation that would eliminate the audit committee's right to determine when an audit committee should change auditors would be contrary to the spirit of SOX, and would weaken corporate governance. Instead, the role of the audit committee should be supported and strengthened.

Mandatory firm rotation would reduce choice of audit firms available to the audit committee, and would eliminate from the audit committee's consideration the existing firm, which in fact may be the best choice as that entity's auditor. This would be an unnecessary restriction on audit committee choice of audit firms. That lack of choice could be made worse by other factors, which could result in selection of an audit firm that was not the best choice to meet the needs of the entity.

Other Considerations

To continue to improve audit quality, we must make progress along several dimensions. First, we must continue to focus on increasing objectivity and skepticism, and we have shared several processes at Crowe designed specifically to achieve those objectives.

Second, we must recognize the fact that, as documented in a number of comment letters, auditors often become more effective over time as they learn more about the companies they audit. Of course, there are a variety of reasons audit committees may choose to change firms and that should continue to be the audit committee's decision. Mandatory firm rotation would result in losing knowledge that need not be lost when there are other ways to improve objectivity and skepticism.

Finally, it is important to consider cost. Changing auditors can be demanding in both time and money, and as with most types of regulatory cost, the burden falls disproportionately on middle market and smaller companies. Middle market and smaller company audit committees want to control their audit costs through active coordination with their auditors and selective bidding at a time of their choosing. Mandatory firm rotation would be an unnecessary regulatory burden to such companies.

We appreciate the opportunity to participate in these important roundtables and look forward to the discussion.