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Introductory Statement of Thomas E. Gard

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PCAOB Public Meeting on Auditor Independence

and Audit Firm Rotation

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Introduction

On behalf of Armanino McKenna LLP, I appreciate the opportunity to participate in this panel to express our views on various means to enhance auditor independence, objectivity and professional skepticism.

I would like to take this opportunity to give the Board a brief overview of our firm. Over the past 50 years, Armanino McKenna has become the largest California-based accounting firm with over 350 professionals located in the San Francisco Bay Area and throughout the West Coast. We provide audit, tax and consulting services to a diversified client base operating in multiple industries. Our audit clients are both privately-held and publicly-traded and include many with either national or international operations. Typically, these accounts are headquartered in the Bay Area with multiple locations either across the country or around the globe. We have provided services to registrants for nearly 20 years, including services in connection with various offering statements.

Enhancing Audit Quality

Quality is the cornerstone of our firm's audit service approach. We are proud that the results of our peer reviews and periodic inspections demonstrate the quality with which we approach our work. The primary goal of our profession has to be to develop and preserve investor and creditor confidence in financial information. Anything less than that is not acceptable. I think most of us could agree on this objective. If we do not enhance investor and creditor confidence in the client's financial statements, we must question the value of the service we are providing.

The pursuit of audit quality is a major objective for standard setting organizations around the world. In December 2011, various audit reform proposals were advanced in the European Union including mandatory rotation of audit firms with defined cooling off periods and prohibition from providing non-audit services to public interest entities. Similar requirements are being evaluated around the globe to determine their effect on audit effectiveness. We applaud all actions toward the goal of increasing audit effectiveness.

Audit firm rotation is a significant consideration. Since the adoption of the Sarbanes-Oxley Act, engagement partner rotation has been required after 5 years. If audit firm rotation is to be implemented, the ramifications of such a change will need to be fully evaluated. The costs and benefits of such a change must be weighed and balanced.

Requiring rotation of the audit firm will have some negative consequences. These have been discussed repeatedly in prior public meetings and comment letters. I will not repeat all of these possible consequences here. However, a main ramification is the disruption caused by any change and the additional time and effort required to bring a new audit firm up to speed with the company being audited. No matter how well coordinated the transition is, a change does involve significant time and effort of both registrant and audit firm personnel.

It is also my experience that it may take an audit firm at least one audit cycle, if not more, to fully acquaint themselves with the company being audited to be able to design and implement the most effective audit that they can plan. Thus, audit firm rotation may actually decrease audit effectiveness in the early years of a rotation. This statement in no way implies that the first year audit is in some way deficient; it is just not planned with the same level of understanding of company operations that is obtained after going through the entire audit process. Subsequent audits benefit from this understanding and the efficiency and effectiveness of subsequent years' audits improve.

The main driver for audit firm rotation is to prevent complacency in the auditor by introducing new perspectives at regular intervals. However, I am not aware of strong evidence showing a direct correlation between auditor tenure and audit deficiencies, much less the amount of time before complacency begins to occur. The PCAOB in its Concept Release stated, "Preliminary analysis … appears to show no correlation between auditor tenure and number of comments in PCAOB inspection reports." Thus, are we considering a remedy to audit deficiencies that will not be effective?

In any respect, doesn't the rotation of the engagement partner already make significant strides towards preventing such complacency? Certainly, a new perspective and a fresh "re-questioning" of audit approach and past decisions is inherently healthy in the audit process. Thus, are we really obtaining diminishing returns on improving audit effectiveness by requiring audit firm rotation in lieu of the current audit partner rotation? Are the costs incurred to rotate the audit firm worth the incremental benefits?

We do see one potential benefit of audit firm rotation that should not be understated. In a marketplace with many viable audit firms vying for a company's business, there should be inherently healthy competition. A company can typically choose its audit firm from firms of varying size, skill-sets and demographics and with certain differences in audit approach.

However, for registrants, the over-whelming audit service provider are National firms, and of National firms, very markedly Big Four firms. Thus, the competitive landscape in selecting an audit firm for public companies is very different from the landscape enjoyed by private companies. Preference for National firms is dictated by several factors, some very valid and other reasons perhaps legacies from common practice.

Certainly very large public registrants may require the largest of public accounting firms to benefit from the audit firm's geographical diversity and locations. However, many registrants are not as geographically spread and could benefit from the service approach that smaller firms provide. We believe there are many registrants that a regional firm like ours can service in a more responsive manner; where we are just a better match of resources to the company's primary needs. However, given the current competitive landscape, the frequency of registrants looking beyond the National firms is low. Underwriters, private equity firms, and financial institutions with long business relationships with various National firms help perpetuate this marketplace. Again, sometimes warranted for the size or geographical footprint of the company in question, but many times not.

Requiring audit firm rotation could assist in changing the competitive landscape for audit services to registrants. As the vast majority of registrants are audited by the Big Four accounting firms, requiring audit firm rotation would make for some interesting decisions for registrants. Many times consideration of other Big Four firms is not feasible as many may be conflicted given other services provided to the registrant. It is not uncommon for a registrant to utilize other firms to perform tax provision, internal audit, internal control, IT, and valuation services. Thus, the registrant's choices upon firm rotation may be few if they solely look to the National firms and more particularly, the Big Four firms. With fewer alternatives, perhaps the registrant will be more inclined to consider Regional audit firms. More likely, other large firms will make the investment to become stronger national and/or global firms to increase the alternatives available to large registrants. Competition generally leads to new solutions and providers. I do not believe we should be afraid of increasing competition because the pool of large audit firms now appears small. If the opportunity is strong, other providers will position themselves to fill this need, especially given lead time to prepare.

Requiring audit firm rotation could lead to a more interactive and participatory market for audit services. This increased marketplace will provide more options to the registrant and thereby will enable the registrant to find the firm that best fits the registrant's particular needs and circumstances. Long-term increased audit quality of course cannot be compromised. However, competition generally leads to innovation and improvement, results that investors and creditors will value.

The benefits and costs of mandatory audit firm rotation are difficult to quantify with precision, but must be carefully weighed.

Concluding Remarks

I want to express my appreciation to the PCAOB for the opportunity to participate in this panel. I look forward to continued dialogue and evaluation of this issue.