



FIRE & POLICE PENSION ASSOCIATION OF COLORADO

October 10, 2012

Public Company Accounting Oversight Board  
1666 K Street, N.W.  
Washington, D.C. 20006

**Re: PCAOB Rulemaking Docket Matter No. 37 – Concept Release on Auditor Independence and Audit Firm Rotation**

Dear Members of the Board:

I submit this written statement in conjunction with my remarks before you at the hearing scheduled in Houston on October 18, 2012. Please note that this written statement, and my remarks, are my own and do not necessarily reflect the views of the Fire & Police Pension Association of Colorado (FPPA). However, my experience as Chief Executive Officer of FPPA and my prior experiences as Executive Director of the State Universities Retirement System of Illinois and as a partner of a small law firm have helped form my opinions on the issues of auditor independence and audit firm rotation.

I have read with great interest the transcripts of the prior hearings and select comment letters. The information presented has helped focus and evolve my thinking on the issues presented. I will comment specifically on audit firm rotation and more generally on issues of auditor independence.

FPPA is a relatively small public pension fund, managing approximately \$3.5 billion in defined benefit assets and administering defined contribution assets of approximately \$350 million. The majority of our defined benefit equity allocation is passively managed, or indexed. Thus, we are the market and cannot easily “vote with our feet” and remove our ownership from a company whose financials are suspect. As a result, integrity in the capital markets is of paramount importance to us.

Auditors play a critical role in this process. I have talked over the years to various portfolio managers at investment firms. While each firm will have its own metrics that it will apply to the financial information it has on portfolio companies, that analysis generally starts with a review of audited financials. If that base information can't be relied upon, then the investment decision will be flawed.

Most, if not all, commenters have conceded the inherent conflict of interest that results from the “issuer pays” model. Mandatory audit firm rotation would ameliorate this conflict of interest to some extent but would certainly not remove it. Absent a move from the “issuer pays” model, the PCAOB cannot eliminate the conflict but can only take steps to minimize it.

## **Audit Firm Rotation**

It is my opinion, however, that mandatory audit firm rotation is too blunt an instrument to be used at this time.<sup>1</sup> I suggest that several interim steps, related to rotation, might be considered by the PCAOB. Some interim steps that might be worthy of consideration are:

- The PCAOB mandates the replacement of an audit firm by an audit committee when there are audit deficiencies noted that are significant enough to warrant such a step.
- Further restrictions on the provision of non-audit services are implemented, so that companies have a non-conflicted alternative to their current audit firm. This would be more feasible if it could be implemented at the company level rather than the audit firm level.
- The retention of the auditing firm should no longer be considered a routine business matter in terms of proxy access and shareholder voting. Enhanced disclosure of information, policies and decisions regarding auditor selection and retention will benefit shareholders and make the auditor ratification vote less “routine”. I realize that this is more properly a matter for the Securities and Exchange Commission, but a position taken by the PCAOB on this matter might help bring change about.

## **Auditor Independence**

I believe that there are other options to improve auditor independence that should be considered by the PCAOB.

I am in favor of the proposal submitted by Robert Pozen to require a mandatory RFP for an audit firm once every certain number of years, but I

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<sup>1</sup> I reach this opinion with some trepidation, as I am conflicting with the view taken by Richard Kaplan, one of my former law professors. I was a student in one of his “Accounting Issues for Lawyers” classes and benefited immensely from that experience. However, I do agree with Professor Kaplan’s analysis of the problems presented by the issuer pays model and the problems presented by a lengthy audit firm tenure.

would modify Mr. Pozen's proposal to say that it should be no more than every ten years. Like Mr. Pozen, I would allow the audit committee to retain the incumbent. I would require a discussion as to the factors that were considered in retaining the incumbent if that were the decision. I agree with Mr. Pozen's contention that merely going through the RFP process would add value to the decision of the audit committee on audit firm change or retention. Furthermore, the RFP process would clarify, in those situations where the audit firm has been retained for decades or at least prior to Sarbanes-Oxley, that the hire decision is now made by the audit committee as opposed to management.

Other items that I believe are worthy of consideration by the PCAOB to enhance auditor independence are:

- Addition of an "auditor's discussion and analysis" to the audit report.
- A requirement that the engagement partner sign the audit opinion.
- A requirement that auditors have qualitative discussions with the audit committee regarding areas of judgment, estimates, etc.
- Further restrictions on the scope of non-audit services. I anticipate this would have the dual effect of reducing conflicts of interest and also enlarging the pool of potential competitors for an audit engagement.
- Enhanced communication from the PCAOB to audit committees generally on the duties of audit committees and particularly on inspection issues with respect to the auditor retained by the audit committee.

Thank you for the opportunity to comment. I look forward to discussing these important issues with you.

Sincerely,



Dan M. Slack  
Chief Executive Officer