

December 12, 2011

Mr. J. Gordon Seymour
Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

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

Dear Mr. Seymour:

PKF International Limited ("PKFI") is pleased to submit comments to the Public Company Accounting Oversight Board ("PCAOB" or the "Board") on the PCAOB's Concept Release, *Auditor Independence and Audit Firm Rotation* (the "Concept Release").

PKFI is a highly ranked worldwide network of legally independent member firms providing local expertise in accounting, auditing and business advisory services. There are about 245 member firms and exclusive correspondents in 445 locations in around 125 countries, employing about 21,000 people, and with overall revenue of approximately \$2.4 billion. In 2010 PKF International was ranked the 10th largest network by the International Accounting Bulletin World Survey.

PKFI member firms are committed to the values of integrity, professionalism and independence - as well as the desire to share their skills and knowledge across borders to provide their clients with a world-class range of services at world-class standards. PKFI is a full member of the Forum of Firms - an organization dedicated to consistent and high quality standards of financial reporting and auditing practices worldwide. Full membership in the Forum of Firms includes, among other requirements:

- Maintaining quality control standards in accordance with the International Standard on Quality Control (ISQC 1) issued by the IAASB in addition to relevant national quality control standards – for member firms of PKFI that are registered with the PCAOB, this includes adherence to the rules and standards of the PCAOB for registered firms;
- Conducting, to the extent not prohibited by national regulation, regular globally coordinated internal quality assurance reviews;
- Having policies and methodologies that conform to the IESBA *Code of Ethics for Professional Accountants* and national codes of ethics – again, for US member firms of PKFI that are registered with the PCAOB, this includes compliance with PCAOB Standards and PCAOB rules; and
- Agreeing to submit to the Secretary of the Forum an annual report, in an approved format, indicating that it meets the membership obligations set forth above.

PKFI fully supports the Board's objective to enhance and improve audit quality, with particular emphasis on auditor independence, objectivity and professional skepticism. We believe these are benchmark elements by which our profession must conduct itself in order to earn and keep the public's trust in our

work and our profession. In particular, we believe that objectivity, professional skepticism and audit quality have improved markedly since the passage of the Sarbanes-Oxley Act of 2002 (the "Act"). In addition, the creation of the PCAOB has added to the public's confidence that the profession is being held accountable to these critical attributes. Of course, we agree with the Board that the profession must continue to find ways to make further progress in these areas. It is essential that we and other firms work with the PCAOB to explore actions that would further improve audit quality and better serve the interests of investors and other key stakeholders in the financial reporting process.

At PKFI, we believe our independent member firms approach their duties with a strong sense of principles, ethics and professional skepticism. Employing such skepticism and maintaining objectivity is critical to the execution of audits. Without the application of these principles, the investing public would quickly lose confidence in the work of PKFI member firms.

Should the Board focus on enhancing auditor independence, objectivity and professional skepticism?

We believe the central mission of the Board should be to focus on enhancing audit quality, and addressing auditor independence, objectivity and professional skepticism as part of that focus. Last week, Helen Munter, Director of the Division of Registration and Inspections for the PCAOB, made the following comment at the AICPA National Conference on Current SEC and PCAOB Developments:

"Professional skepticism is the bedrock of auditor independence and objectivity."

We fully agree with Ms. Munter's statement. Without professional skepticism, our profession would not be able to properly maintain its objectivity or appearance of independence. Without the investing public's acceptance of our objectivity and independence, as noted above, PKFI member firms would not be able to survive in the market place.

While we fully support the Board's mission to enhance auditor independence, we do not believe this is the proper time to introduce firm mandatory rotation provisions. The Board has recently adopted several new standards and rules, including standards that address how an auditor should assess risk and perform the audit as well as rules governing the assessment of independence and communication of various matters to the audit committees of issuers. We believe these standards and rules should be allowed to "season" and to be evaluated for their effect on professional skepticism, objectivity and improved audit quality.

What are the advantages and disadvantages of mandatory audit firm rotation?

We believe the disadvantages of mandatory audit firm rotation far outweigh the perceived advantages. Specifically, we note the following:

- The implementation of mandatory audit firm rotation could lessen the importance of audit committee judgment. With the passage of the Act, audit committees have become more empowered to monitor and control the conduct of the audit and the auditor. An effective, properly functioning audit committee probably has the single largest impact on audit quality. Their mission is to ensure the auditor is allowed to perform his or her work without impedance or interference from management. We believe an effective audit committee, coupled with the

proper tone at the top of an issuer, will contribute more to meaningful financial reporting than any other solution present or proposed.

- By requiring mandatory audit firm rotation, the Board runs the risk of adding credence to the belief that an audit is a commodity. Certain firms, and even within those firms, certain auditors, are recognized as specialists by industry or financial reporting topic. The implementation of mandatory audit firm rotation could have the unintended consequence of telling the market place that all audit firms and all auditors are equal – that industry expertise and topical expertise are not important in the proper execution of an audit.
- Mandatory audit firm rotation may further restrict the involvement of non-international firms in the audits of issuers. The investment in training, expertise and specialization for audits of issuers is a significant investment for registered firms. This investment is proportionally larger for local and regional firms. By placing an arbitrary cap on the length an audit firm can be engaged by an issuer, local and regional firms could face greater risk of return on these investments. There can be no assurance that such firms would be able to maintain the revenue stream from issuer audits in order to recover and maintain the investment in training necessary to properly conduct an audit of an issuer. This could lead to further concentration of the audit market for issuers.
- As noted above, a key element in auditing certain issuers is industry expertise. By limiting the amount of time a firm is allowed to be engaged as an issuer's auditor, there could well be a dilution of such industry expertise. This could well lead to lower quality audits, clearly contradictory to the Board's key mission.
- Group audits of large, multinational issuers could be adversely affected by industry expertise and jurisdictional issues. As noted above, industry expertise is an important factor in audit quality. In some locations, such expertise may not be available amongst a sufficient pool of audit firms. In addition, different jurisdictions could have different requirements on rotation. It is conceivable that compliance with one country's mandatory rotation rules could lead to a violation of another country's regulations regarding auditor appointment and/or tenure. Such conflicts could only increase the administrative burden on auditors and regulators, as well as the cost and complexity of performing group audits of large multinational issuers.
- In general, switching audit firms results in higher costs of the audit in the first and/or second year of the audit relationships, both to auditors and issuers. Mandatory firm rotation requirements would make recovery of such costs either less likely, which could lead to lower quality audits, or drive up the costs of audits to issuers and their owners. As noted in the Concept Release, the GAO 2003 report, conducted pursuant to the provisions of the Act, noted that initial year audits cost increase as much as 20%. There is no assurance that issuers and the users of financial statements would see any benefit from this higher cost. Indeed, there is substantial risk, due to factors noted above, that the users of the issuers' financial statements may see lower quality audits.

As for any potential advantage of mandatory audit firm rotation, we believe the main advantage would be one of appearance over substance. However, taking an action simply for the sake of taking an action

generally results in unintended consequences that could have been avoided by careful study and potentially no action at all.

What effect would a rotation requirement have on audit costs?

We believe one of two outcomes could happen as a result of mandatory rotation requirements. The first is more fully explained above – initial audit costs could rise significantly with little assurance of a corresponding benefit. The second potential outcome is that audit quality could suffer. While this may directly impact audit cost, there is clearly a true cost to lower audit quality.

By enforcing mandatory rotation requirements, issuers without a strong audit committee could wind up placing more reliance on management for recommendations for the selection of auditors. One of the key objectives of the Act's provision was to ensure the audit committee had full ownership of the auditor relationship. However, most audit committee members function in a part-time capacity and may not have the means or resources to screen potential audit firms. This could well fall to management, thereby creating the very conditions the Act sought to remedy. This could result in lower audit quality, which carries hidden costs at all stages and very real costs if an audit fails.

Would audit firm rotation enhance auditor independence, objectivity and professional skepticism?

We believe that the fundamental measure of any standard or rule issued by the Board should be whether it will increase audit quality. We do not believe a mandatory rotation provision would enhance audit quality for reasons noted below. In fact, studies have shown that audit failures are more likely in the first year of an audit relationship.

The first reason requires an understanding of how a quality firm approaches its professional responsibility under the standards and rules of the Board. As auditors, we trade only on our reputation. If we were to sacrifice independence, objectivity and/or professional skepticism, our reputation as quality firms would disappear quickly and the market would not allow such firm to survive for long. Furthermore, the partners and staff of quality firms are dedicated professionals who are committed to uphold the key pillars of our profession. A mandatory rotation provision would not change this commitment.

The second reason relates to the developments of the past ten years– we believe the passage of the Act and the creation of the Board has allowed the audit profession to restore balance. By this, we mean that we believe we have better legal and moral underpinning to focus on performing quality audits. In addition, the Board's inspection process has created an era of accountability not experienced in a formerly self-regulated profession. The Board has several tools at its disposal to enforce this accountability and has demonstrated a willingness to use these tools, such as:

- Rejection of registration applications,
- Issuance of inspection reports that openly criticize audit deficiencies,
- Exposure of nonpublic portions of an inspection report when a firm fails to remediate quality control defects, and

- Dispensing of enforcement actions that penalize, and even bar, auditors who do not observe professional standards and regulations.

We believe continued application of these tools will allow the Board to achieve its mission of improved audit quality, including better objectivity and professional skepticism, which leads to enhanced auditor independence.

Should the Board drop the current rule making process on mandatory firm rotation?

Yes, we believe the Board should drop the current rule making process on mandatory firm rotation. We further believe the Board's efforts would be better spent focusing on improved PCAOB Standards, enhanced rule making and improving the timeliness of inspection reports. Each of these areas of focus would do more to enhance audit quality than devoting valuable Board resources and attention to a mandatory firm rotation that has not been evaluated in practice.

Are there alternatives to mandatory rotation for the Board to consider?

Yes, we believe there are several alternatives that Board could consider in lieu of a mandatory rotation provision, including the following proposals:

- The Board could conduct a formal evaluation of inspection findings to determine if there is indeed a link between audit firm tenure and decreased audit quality. The Board and its staff have conducted "root cause" studies in the past and the publication of these studies have been beneficial to the investing public as well as the auditing profession. In fact, the Board may want to consider providing guidance to the Division of Registration and Inspections on how to enhance the inspection process to assess factors it believes would demonstrate a causal linkage between tenure and quality. The Board has valuable resources at its disposal to determine such guidance, such as the Standing Advisory Group and Investor Advisory Group.
- Another alternative could be to examine the effects on audit quality, professional skepticism and objectivity during the normal course of auditor changes. The Board could design an inspection and study program that would look at the audit immediately preceding the change in auditors and the audit immediately after the change. Observations could be summarized and analyzed to determine if there is in fact a pattern that demonstrates an impact on audit quality.
- The Board should allow the recently issued Standards and rules sufficient time to determine their impact on audit quality, as demonstrated through independence, professional skepticism and objectivity. Studies could be designed to formally evaluate these recently issued standards and rules and link the results to a "root cause" analysis recommended above.

Should there be an evaluation of the role of the Audit Committee in audit quality?

While this is not a specific question raised in the Concept Release, we believe it is important to evaluate the role of corporate governance generally and the role of the audit committee specifically to determine the effects on audit quality. We understand that the SEC maintains jurisdiction over the conduct and

objectives of audit committees. However, absence of an effective audit committee and/or a strong corporate governance culture cannot be overcome by changes in an audit firm. It really is about tone at the top, and that can only come from issuers themselves. While we have a responsibility to identify and report misstatements, including those related to fraud, an ineffective audit committee or a poor corporate governance structure will simply remove those firms that address such shortcomings.

We believe the Board could encourage the SEC to further clarify the financial expert rules for the audit committee. Such a designated financial expert should have a deep and thorough understanding of financial reporting requirements, including a fundamental understanding of financial reporting standards, as well as a working knowledge of the rules and standards of the audit profession. Furthermore, we believe the PCAOB should involve the audit committees in the inspection process more than is current in practice. One way to do this is to require audit committees to be involved in the comment process. Another way would be to involve audit committees in the general inspection process by interviews and other forms of direct access by the inspectors of audit firms. Such direct access could yield additional insight to how effective the auditor is at maintaining independence, objectivity and professional skepticism.

Concluding remarks

In summary, we support the Board's continued efforts to improve audit quality including its concerns about independence, objectivity and professional skepticism. Further, we believe that much progress has been achieved by the passage of the Act, the creation of the Board and the Board's execution of its mission as mandated by the Act. Current and pending proposals should improve audit quality beyond the progress we have seen to date. However, a mandatory firm rotation provision does not appear to have demonstrable benefits and yet at the same time could impose adverse unintended consequences on audit quality and impair the ability of the users of issuers' financial statements to rely on those audits.

We would be pleased to discuss our comments, proposals and remarks with the Board or its staff.

Sincerely,



WOLFGANG HOFMANN
CHAIRMAN OF THE BOARD OF PKF INTERNATIONAL LIMITED