

December 14, 2011

Via email to [comments@pcaobus.org](mailto:comments@pcaobus.org)

Office of the Secretary  
Public Company Accounting Oversight Board  
1666 K Street, N.W.  
Washington, D.C. 20006-2803

Re: PCAOB Rulemaking Docket Matter No. 37

Ladies & Gentlemen:

We appreciate the opportunity to respond to Concept Release No. 2011-006 – *Auditor Independence and Audit Firm Rotation* (the “Release”).

The undersigned are members of management and the audit committees of some of the largest engineering and construction companies in the U.S. (“we”, “us”, “our Industry” or “the Industry”). Although each company has its own perspective on the issues of auditor independence and the mandatory rotation of audit firms, this letter represents a group response because each of us believes that mandatory rotation of audit firms will present significant challenges to our Industry, including significant increases in costs without the related benefits described in the Release. Accordingly, we are unified in our view that the Release represents a “cure that is worse than the disease” the PCAOB believes exists and hopes to quash.

### **Summary**

We agree with the PCAOB (the “Board”) that auditor independence is critical to our shareholders, bankers, sureties, clients, and other stakeholders. The independence of the audit firms rendering opinions on the financial statements we issue is essential in maintaining the confidence of our stakeholders that our financial statements present fairly our financial condition, results of operations, and cash flows. And although we recognize that the primary goal of the Release is to strengthen the independence, objectivity, and professional skepticism of our audit firms, we firmly believe that our auditors are independent of our management, unimpaired by their status as the “incumbent auditors” on our accounts.

Accordingly, for the reasons discussed below, we believe that mandatory rotation of audit firms:

- Will *not* enhance auditor independence or improve auditor objectivity;
- Will increase the costs for our organizations;
- Will create inefficiencies in the audit process; and will likely increase the risk of audit failures; and,
- Usurps the authority and responsibilities of our audit committees.

### **Need for Change**

We believe the Release falls short in making a persuasive case for mandatory auditor rotation. The Release does not clearly establish a link between auditor tenure and the types, frequencies, and severities of the audit failures the PCAOB observed through its inspections. The Release is conspicuously silent in providing details of the audit failures it detected, and our audit committees are not provided with the detailed results of the Board's inspections which would allow them to make their own conclusions about this issue. The Board must understand that our companies have not been associated with any audit failures. Accordingly, we believe it is incumbent that the Board establish and demonstrate a clear connection between auditor tenure and errors or omissions in financial statements (rather than audit failures) before concluding that such a drastic and disruptive change as mandatory auditor rotation will improve audit quality and the reliability of financial statements. In general, we don't believe that technical departures from generally accepted auditing standards or procedures that did not contribute to a material misstatement in a set of audited financial statements warrant the cost inherent in mandatory rotation of audit firms.

When assessing the need to revamp audit requirements, we believe the issue of financial statement accuracy and reliability should be important factors for the Board to consider. We believe the Board correctly defines "audit failure" in the Release as a failure to obtain reasonable assurance about whether the financial statements are free of material misstatement. However, it does not necessarily follow that an audit failure will result in materially misstated financial statements.

We understand and agree that an audit failure may increase the risk that a material error in a set of financial statements may go undetected, and therefore we do not mean to imply that the causes of audit failures, whatever they may be, are irrelevant. On the contrary, we believe in the importance of auditor independence, but are merely suggesting that the nature of the audit failures discovered by the Board through its inspection process may be remedied by other, less radical and less costly means than the mandatory rotation of audit firms.

We also take exception to the implication in the Release that lengthy tenures by audit firms result in unhealthy coziness between them and their clients. What the Release depicts as “cozy” may in actuality be a deep level of understanding that the auditor has of his client’s business practices, ethics, methods of managing risk, and tendencies to apply aggressive or conservative accounting. The relationships we have with our auditors are symbiotic. Because of the vast business experience possessed by our audit firms, we seek their advice when considering the proper accounting for complicated transactions (the ultimate accounting, of course, is up to the Company to determine). However, that advice is more meaningful and more likely to reflect the underlying economics of such transactions if our auditors have a thorough understanding of our business and business practices. Through frequent interactions with our management teams and audit committees that occur over time, our auditors develop such an understanding, which is used not only in providing advice to us but also in developing their audit approaches and determining the extent of testing they will perform.

Lastly, we question the weight, if any, that the Board should place on the comments they received from its IAG in assessing the benefits of mandatory auditor rotation. On page 15 of the Release, it is reported that:

“On March 16, 2011, at a meeting of the Board's Investor Advisory Group (‘IAG’), some members of the IAG . . . urged the Board to consider mandatory firm rotation in the context of lessons learned from the financial crisis. These IAG members stated that ‘key to concern over independence was the level of ‘coziness’ the firm had with the management of the company being audited’ and noted that ‘[m]any of the auditors of the large companies involved in the financial crisis ... had long running audit relationships with those companies.’ ”

It strikes us as a bit of an overreach to associate any aspect of the global recession to auditor tenure, and it concerns us that the Board may rely on such spurious conjecture in order to justify such a significant rule change. The events and circumstances that lead to the global recession had nothing to do with auditor tenure.

### **Costs, Audit Efficiencies, and Audit Quality**

Mandatory auditor rotation will significantly increase the costs for our Industry. To appreciate this, the Board must understand not only the volume of assurance services we procure in a typical year, but also how important it is that these services be provided by a single firm as part of an integrated audit of our companies.

In addition to the annual audit of our consolidated financial statements, we, like most global companies, have numerous subsidiaries domiciled in countries around the globe, the annual financial statements for many of which require an audit. In addition to the audits of our subsidiaries, we also typically procure the following assurance services:

- Audits of the financial statements of our joint ventures;
- Audits, reviews, compilations or other assurance-type services covering the financial statements or selected financial information relating to subsidiaries holding contractors licenses in the U.S. (required as a condition to issuing or renewing such licenses); and
- Audits of our “overhead” cost pools and rates (required by many state and local agencies to whom we provide engineering and construction services and, in certain circumstances, to the U.S. federal government in connection with contract close-outs or proposals).

These assurance services point to the efficiencies and economies that can be achieved by aggregating this work under a single firm. We know through experience that the cost of these services are reduced when a single firm can leverage off the testing it performs for one audit and apply it to a separate engagement. By having a single firm perform these assurance services, our overall costs of doing business are reduced.

Mandatory rotation of audit firms will require us to choose which ancillary audits (and other professional services) to transfer to the successor firm that signs the accounts we file with the U.S. Securities and Exchange Commission (the “Principal Auditor”) and which services to leave with the legacy audit firm. The more ancillary assurance services we transfer to the new Principal

Auditor, the more inefficiencies we will experience due to the multiple learning curves that will have to be resolved, which will inevitably result in higher costs for us. And, if we choose to keep the legacy audit firm for certain engagements, our audit costs will also increase as the new Principal Auditor will need to incur time to assure itself that it can rely on the work of the legacy audit firm. In either situation, our costs will increase.

For our industry, there will be a tendency to appoint the new Principal Auditor as the provider for the other audits and assurance reports we require. Because we try to source project-related engineering and design work to resources within our companies regardless of location (e.g., it is not unusual for us to have engineering services performed in, say, one of our offices in the U.S. for a project that is held and otherwise performed by one of our subsidiaries in Europe), prudence dictates that we have a single audit firm testing our controls, transactions, and financial statement balances across geographic boundaries to ensure, if for no other reason, that those projects that are being executed in a multi-office environment are being accounted for consistently across our respective companies.

Accordingly, any rule requiring companies to periodically change audit firms will drastically increase the cost to do business for companies in our industry. The learning curve that is mentioned in the Release is a very real issue for our companies. In order to maximize the benefits of the audits performed by our auditors and in order to ensure that any material departures from GAAP or our respective systems of internal control are promptly reported to our audit committees, we appoint our Principal Auditors as the auditors for many of our subsidiaries. Each new appointment will therefore generate start-up costs that will extend into at least the first three years following rotation. This cost is unnecessary and unjustified in today's economic times.

In addition to the increased external costs that will be imposed on us as a result of mandatory rotation of audit firms, we will incur substantial additional internal costs as well. The knowledge base and experience of our existing firms — knowledge that will be destroyed by mandatory rotation — can only be replaced over time, and after an inordinate number of hours of internal company time is spent with the successor auditor trying to rebuild that knowledge. This internal effort would be expended at all levels within our organizations — by audit committees; senior management; accounting staffs; IT departments; legal department; and internal audit staffs. Furthermore, we fully expect that a significant portion of such time will be spent with the successor

audit firms explaining to them the specific procedures that were performed by the predecessor firm, and jointly trying to understand why the predecessor firm may have performed certain of the procedures they did so that the successor firm may decide if they want to perform similar procedures.

We therefore concur with the Cohen Commission's conclusion as quoted by the PCAOB on page 11 of the Release:

“Because the Cohen Commission believed that ‘the cost of mandatory rotation would be high and the benefits that financial statement users might gain would be offset by the loss of benefits that result from a continuing relationship,’ it recommended against mandatory audit firm rotation.”

### **Increased Risk of Audit Failures**

Many of the contracts we perform relate to projects that are extraordinarily complex and span over many months (and sometimes years). Compliance with the terms of our contracts drive revenue recognition and requires management to assess not only our performance, but also the financial affects of claims, the collectability of receivables, issues with subcontractors, and the overall client relationship. Accordingly, the accounting we do in our Industry can be very complex and can require a significant amount of judgment. It is therefore important that our auditors understand our projects in order to test the various assumptions we make.

It is likewise very important for our auditors to understand *how* we perform our contracts. Whether a contract is being performed entirely from a single office or is being executed in a multi-office environment exposes the audit process to certain types of audit failures, particularly as the process relates to ensuring that all revenue and costs have been properly recognized. Mandatory rotation of audit firms exposes our audits to the risk that the principal auditor will be replaced at a point when its knowledge of a material project is critical to ensure that the related contract is properly accounted for.

It is not only the knowledge of our projects that becomes institutionalized within our audit firms, but also the behavior patterns of our clients. Since a substantial portion of our respective backlog consists of contracts with customers we've worked with in the past, experience with how our clients interact with us and how they respond to claims and other project issues is knowledge

that cannot be easily transferred to any successor auditor. Accordingly, we believe that the risk of audit failures with respect to the accounting we do for the projects we perform will increase, perhaps significantly, during the first few years of a new auditor's appointment.

Another area to consider is the interplay between tax and audit. Many companies within our industry procure tax services from our Principal Auditor. The global recession has caused many government agencies and their tax authorities to increase their examinations as a means of increasing revenues. This situation, combined with the inherent complexities of the contracts we perform, makes it extremely important that our audit team provide information they obtain during the course of their audits to the tax team in order to ensure that transactions are properly accounted for with respect to income taxes. This is necessary to ensure that our consolidated financial statements properly reflect the tax effects of our transactions. Mandatory rotation of audit firms will disrupt the free flow of information that currently takes place and will undoubtedly increase the risk of audit failure.

Our concerns about the increased risk of audit failures that would accompany any rule that required the mandatory rotation of audit firms are not isolated to our Industry. Indeed, this concern was noted by the GAO in its 2003 survey:

“According to the GAO's survey, 79% of larger audit firms and Fortune 1000 companies that responded believed that changing audit firms increases the risk of an audit failure in the early years of the audit, and most believed that mandatory firm rotation ‘would not have much effect on the pressures faced by the audit engagement partner. Nearly all of the larger firms that responded estimated that initial year audit costs would increase by more than 20 percent.’”

[Page 14 of the Release]

We also wish to bring to the Board's attention that, conscious of the perception shareholders have of the level of fees we pay our audit firms, many of us already use firms other than our Principal Auditor for certain services where efficient. For example, it is not unusual for us to use firms other than our Principal Auditor for due diligence services, certain tax consulting, expatriate tax services, and internal audit services, to name a few. Accordingly, if mandatory rotation of audit firms is adopted, it may not be possible for us to retain one of the other large CPA firms as our new Principal Auditor. We may be required to engage smaller firms in the future —

firms that may not possess the resources or technical expertise necessary to perform a quality audit in those circumstances. This situation will undoubtedly increase the risk of audit failures in the future.

Thus, we echo the concerns expressed on pages 16 and 17 of the Release that the risk of an audit failure increases in the early years of an audit relationship. As we have described in detail above, a new auditor has a significant learning curve to overcome in the first few years of an audit relationship, which increases the risk of the auditor underemphasizing critical areas and/or overemphasizing low risk areas simply from a lack of knowledge or understanding of the business.

### **Usurping the Responsibilities of Audit Committees**

Relatively speaking, audit committees are fairly new institutions. And although they are beyond their infancy stage, audit committees have had to evolve during some of the most tumultuous economic times the U.S. and other major economies have seen. Accordingly, unless the Board is absolutely convinced that audit committees are not competent to assess the independence of its auditors, we believe the practical solution to assuring auditor independence is to allow audit committees to “do their jobs”. Audit Committees should continuously monitor the relationships between management and audit firms and to take those actions they deem prudent and advisable to ensure the integrity of the audit reports that are issued on their companies.

The U.S. Securities and Exchange Commission first recommended that boards of directors of public companies establish and maintain audit committees in 1972. Since then, various bodies, committees, and commissions have recommended “best practices” for audit committees, and various laws and regulations have been enacted to help audit committees and to clarify their roles and responsibilities. The most recent set of regulations stems from the Sarbanes-Oxley Act of 2002 (“SOX”).

Although SOX established a number of rules regarding audit firms and audit committees, the enduring value of SOX and the subsequent rules adopted by the Board involve those rules that:

- Requires the mandatory rotation of coordinating audit partners;
- Prohibit audit firms from providing services that may lead to a conflict of interest or otherwise jeopardize their independence (e.g., bookkeeping services, valuation services, internal audit services);



- Require the pre-approval by audit committees of services provided by the auditor;
- Require audit firms to communicate certain matters to audit committees (e.g., the auditor's responsibilities regarding the audit, significant findings from the audit, the selection and application of accounting policies and material changes thereto, etc.);
- Assuring that audit committees are adequately funded; and
- Empowering audit committees with the authority to engage outside advisors as they deem necessary or advisable in order to perform their duties.

We believe these rules provide appropriate guidance to and a reasonable framework for audit committees to help ensure the independence and objectivity of their audit firms. In particular, the requirement that coordinating partners must rotate off engagements every 5 years guarantees audit committees that a “fresh set of eyes” will be applied to the audits of their companies. New audit partners apply their own knowledge and experience when assessing audit risk and when planning the audit and when designing the specific tests they will perform. We also believe that shareholders may properly point to these rules as assurance that the relationship that companies have with their auditors is open and above board.

#### **Other Questions Posed in the Release and by the Board During the August 2011 Open Meeting**

Other questions posed in the Release and by Board members during the Board's open meeting held in August 2011 relating to auditor independence involve (i) selective audit firm rotation, (ii) reconsideration of the audit firm payment model, and (iii) further limitations on non-audit services.

In general, we disagree with any rule change where implementation is done on a selective basis; where smaller or privately-held companies are relieved from a cost that will be forced onto larger or publicly-held companies. Cost structures can be a determining factor for clients in awarding projects to contractors. Accordingly, it would be unfair not to impose the cost of mandatory rotation across our Industry uniformly.

We also do not agree that changes to the auditor payment model will either enhance auditor independence or improve auditor objectivity. Although we would need to review carefully the

specifics of such a proposal, we believe this change will present a tremendous administrative burden to us, and will inevitably increase the cost of doing business.

Similarly, we would need to review the specific non-audit services the Board would like to add to the list of impermissible services before expressing an opinion. However, we believe the current list is prudent, and we are not aware of any non-audit services we currently procure from our audit firms which we believe impair their independence or objectivity.

## **Conclusions**

The reputations and integrity of the firms who audit our financial statements are the most valuable assets they own. Furthermore, each of our audit firms is larger than us financially, such that the loss of our audit work – although painful – would not be a catastrophic loss to them. Accordingly, it is not reasonable to believe our auditors would, in today’s post-Enron era of increased regulation and heightened litigation and oversight, jeopardize either their firms’ balance sheets or reputations due to management pressure, or over the accounting for a particular transaction or maintaining a client relationship.

Mandatory rotation of audit firms is unnecessary, and will impose a tremendous cost to our Industry at a time when we simply cannot afford it. Mandatory rotation of audit firms is an inefficient and unproven method of improving auditor independence and objectivity.

Our conclusions are consistent with some of those of the GAO as quoted by the Board on page 14 of the Release as follows: “mandatory audit firm rotation may not be the most efficient way to increase auditor independence and audit quality . . . .” In spite of the GAO’s conclusion, however, and in spite of the Board’s admission that, “the Board believes that audit quality has improved since the time of the GAO report”, the Board concludes by saying, “[it] believe[s] more can be done to bolster auditors’ ability and willingness to withstand management pressure”. We find it hard to see how, if audit quality has improved since the issuance of the GAO report, adopting an approach rejected by the GAO makes any sense.

We therefore encourage the Board to look more closely at the audit failures it has detected and determine which failures were (i) inextricably linked to auditor tenure and (ii) resulted in a material error to the underlying financial statements. Once these audit failures have been identified,

the Board can re-engage industry and their audit committees to develop practical and less costly changes to auditing standards and the auditor engagement model.

We thank the Board for taking the time to consider our views on this issue.

Very truly yours,

**Jacobs Engineering Group Inc.**

Joseph R. Bronson – *Chair, Audit Committee of the Board of Directors*

John W. Prosser, Jr. – *Executive Vice President, Finance and Administration*

**Fluor Corporation**

Kent Kresa – *Chair, Audit Committee of the Board of Directors*

D. Michael Steuert – *Senior Vice President and Chief Financial Officer*

**URS Corporation**

Mickey P. Foret – *Chair, Audit Committee of the Board of Directors*

H. Thomas Hicks – *Chief Financial Officer*

**Bechtel Group, Inc.**

Nicholas G. Moore – *Chairman, Audit Committee of the Board of Directors*

Peter A. Dawson – *Senior Vice President and Chief Financial Officer*

**CH2M Hill Companies, Ltd.**

Barry L. Williams – *Chair, Audit Committee of the Board of Directors*

Michael A. Lucki – *Senior Vice President and Chief Financial Officer*

**Granite Construction Inc.**

David Kelsey – *Chair, Audit Committee of the Board of Directors*

Laurel Krzeminski – *Vice President and Chief Financial Officer*

**McDermott International, Inc.**

David A. Trice – *Chair, Audit Committee of the Board of Directors*

Perry L. Elders – *Senior Vice President and Chief Financial Officer*

**Chicago Bridge & Iron Company N.V.**

Michael L. Underwood – *Chair, Audit Committee of the Board of Directors*

Ronald A. Ballschmiede – *Executive Vice President and Chief Financial Officer*