October 22, 2012
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
Concept Release on Auditor Independence and Audit Firm Rotation
Release No. 2011-006 August 16, 2011
Reopened for Comment through November 19, 2012

Dear Board Members,

I am submitting my comments to you regarding the above referenced Rulemaking Docket Matter, which was reopened for comment after several public meetings. The comments below are my personal comments and do not necessarily reflect those of my employer. You specifically asked respondents to answer twenty-one (21) questions. I quote the questions directly from the Release.

Term of Engagement

1. **If the [Public Company Accounting Oversight Board ("Board")] determined to move forward with development of a rotation proposal, what would be an appropriate term length?**

   I find it curious that the Board, created by the Sarbanes-Oxley Act of 2002, is contemplating audit firm rotation when this same piece of legislation mandates audit partner rotation in Title II, Auditor Independence, Section 203, Audit Partner Rotation (and a study of firm rotation, which the Board has deemed to warrant the current activity). Recall from the legislation that the "Audit" Partner must rotate off the client after seven years and cannot return for at least two years after that. Lead or concurring partners must rotate off after five years and not return for at least five years after that. The Board could compound critical changes by requiring a change of firms.

   Therefore, if the Board were to require firm rotation, a term of either ten or sixteen years allowing for one or two Audit Partner rotations before the firm rotation may be in order. In each case there would not be the added stress of changing partners and firms at the same time. The outgoing firm's partner would understand the client enough to pass on certain information to the successor audit partner.

2. **Should different term lengths for different kinds of engagements be considered? If so, what characteristics, such as client size or industry, should this differentiation be based on?**

   It was my understanding that we would be rotating audits and audits only of those companies listed on an Exchange in the United States. Furthermore, I do not believe the

Board ought to differentiate among client size or industry. Clients could manipulate both to gain an advantage to put off mandatory rotations. Moreover, client companies in industries where rotation is more frequent could be at a disadvantage with higher audit costs. The Board will recall the outcry over audit costs when Section 404 of Sarbanes-Oxley caused audit costs to escalate as a percentage of revenue.

My opinion has always been that all companies trading on Exchanges in the United States have certain responsibilities to the investing public. Auditors ought to be able to tailor their work to each client and keep the costs within certain parameters. This means that an audit firm rotation requirement, if adopted, ought to be the same for all publicly traded companies.

3. **Does audit effectiveness vary over an auditor's tenure on a particular engagement? For example, are auditors either more or less effective at the beginning of a new client relationship? If there is a "learning curve" before auditors can become effective, generally how long is it, and does it vary significantly by client type?**

I will not soon forget the year when my company's audit firm changed managers on my engagement three times and changed out the entire audit team from the prior years in the same year. The learning curve was steep. To their credit, all of the incoming team members got up to speed on my company quickly. Nonetheless, I did find myself asking the team how much of the permanent file they looked at and how many conversations did they have with prior team members. I found their answer (little to none) rather depressing.

Now factor in a rotation of firms where communication is even less than that! Each firm has certain information and files unique to the firm. This is not information they want to share with competitor firms. This means that teaching the new team will fall on the client personnel.

4. **Some have also suggested that, in addition to being less effective at the beginning of an engagement, an auditor may be less diligent toward the end of the allowable term. On the other hand, others have suggested that auditors would become more diligent towards the end of the allowable term out of concern about what the replacement auditor might find. Would auditors become more or less diligent towards the end of their term? Does the answer depend on the length of the term?**

Perhaps the phrase ought to be whether auditors are less "efficient" in the beginning of an engagement. The Board, wisely, encouraged auditors to use experience gained with a client to tailor the audits [see Audit Standard No. 5, "An Audit of Internal Controls Over Financial Reporting That Is Integrated with An Audit of Financial Statements", par. 57]. Demanding that this valuable information be set aside for mandatory audit firm rotation seems counterproductive. Indeed, I argue that it is. I urge the Board not to adopt a rotation requirement for this reason, and others that follow.

Now let us consider the converse – that auditors would become more diligent, or "audit intensive", as their term limit approaches for fear of being deemed deficient by their successor. The Board has made nearly 3,000 inspections of major firms' work papers by now. The Board's inspectors seem to find deficiencies surrounding whether sufficient, competent evidence has been gathered for the auditor to render an opinion. Professional judgment is a matter of opinion and perspective. I may believe that testing fifty items from a population is ample evidence to render an opinion on a group of transactions. Another person, such as a Board investigator, may believe that seventy-five is the minimum he/she would test before considering an opinion on the transactions. These differences could have developed because of how each entered the profession, that is, which firm they started with; and from experience if something had gone awry on them in the past.

For example, if one auditor looks at management's assessment of inventory valuation, which determines that inventory turns three times a year, as sufficient documentation for opting not to increase a reserve, but another wants some substantive tests, which is correct? One could say that both are correct. One auditor believes that three turns a year indicates that inventory on the shelves will not lose its value. The other auditor may look at that analysis as history, and want to perform tests or research to see what future may hold for the business.

The second auditor, coming into the engagement as the successor, has different methods. Those methods have risk regarding the analysis of potential future events (especially the potential for a downturn in the client's business). The first auditor has had comfort with the valuation method for some years. Is this auditor wrong? Would it be wise of the out-going auditor to increase work on this area. When we increase work, we increase costs. Could it not be argued that one will see audit fees increase as the rotation approaches?

5. How much time should be required before a rotated firm could return to an engagement?

I point back to my response to question one and the Sarbanes-Oxley Act of 2002, Title II, Section 203. Congress felt that partners, depending upon their role in the engagement, could return in two to five years. The Board will need to mesh a firm rotation requirement with partner rotation. For example, if the Board required firm rotation after ten years, but permitted firms to return after two years, the client could simply put the work out to bid and rehire the predecessor firm after two years. In theory, the partner who had rotated onto the client shortly before firm rotation could return to the engagement; picking up where the partner left off, so to speak. Is this what the Board intends? I believe that rotation after five years, with a five year "cooling off period" would reconcile the differences. However, I reiterate that I do not believe firm rotation will produce the results the Board seeks. The Board seeks higher quality audits based upon inspections.

<u>Scope of Potential Requirement</u>

6. **Should the Board consider requiring rotation for all issuer audits or just for some subset, such as audits of large issuers? Should the Board consider applying a rotation rule to some other subset of issuer audits? For example, are there reasons for applying a rotation requirement only on audits of companies in certain industries?**

   As I pointed out in my response to question two, a company that opts to put its debt and/or equity into the open market for trade assumes a responsibility to the public. (It was for this reason that I have written to the Board in the past that no publicly traded company ought to be exempt from Section 404 of the Sarbanes-Oxley Act.) Therefore, I believe that the Board ought not to grant any exception to a rotation requirement for any company. All issuers and auditors would have to face the same cost uncertainty. Otherwise, both clients and auditors may be tempted to alter their business structure to relieve the burden.

<u>Transition and Implementation Considerations</u>

7. **To what extent would a rotation requirement limit a company's choice of an auditor? Are there specific industries or regions in which a rotation requirement would present particular difficulties in identifying an auditor with the necessary skills and expertise? Is it likely that some smaller audit firms might decide to leave the public company audit market due to the level of uncertainty regarding their ongoing client portfolios?**

   For larger companies, the choice would be robust. There are easily upwards of a dozen firms that would seek to compete for the work. However, as companies get smaller, and larger firms opt not to take on smaller clients, the choices go down to regional firms; even large local firms. The Board is wise to ask these questions, and my hope is that these smaller firms respond in ample numbers.

   My instinct tells me that these firms will want to stay close to home; at least initially. For instance, Regional Firm LLC is located just outside Boston, Massachusetts. They have ten partners and a staff of fifty. Competing for work where the client is within a one hour drive makes sense. However, if hotels and overnight stays were to be involved, this firm, as great as they may be, may not want to compete for work requiring overnight travel. This is especially true for firms who do not have experience with this cost factor in pricing their bid.

   By extension, then, we see that where a company is located may play a role in how successful they are in getting audit firms to bid on their engagement. Yes, I can also envision smaller audit firms withdrawing from auditing issuers in order to concentrate on non-public clients they can retain for many, many years. The added advantage to these clients is the firm's ability to perform an audit, prepare taxes, and perhaps perform other work that would not run afoul of Sarbanes-Oxley and the Board's standards.

8. **If rotation would limit the choice of auditors, are there steps that could be taken to allow a company sufficient time to transition out of non-audit service arrangements with firms that could be engaged to perform the audit? Are there other steps that could be taken to address any limitation on auditor choice?**

Once again I find myself thinking back to 2004 and the beginning of Sarbanes-Oxley compliance. A large audit firm was serving as an auditor of financial statements to an organization that another division within the audit firm was the actuary. Naturally, the firm had to decide whether to be the auditor or the actuary.

I see two issues here. One is whether to allow Successor Firm to be awarded an audit when the successor has been providing non-audit services – such as the actuarial services I describe. The transition period ought not to be that long, assuming the client also put the non-audit services out to bid at the same time. I should think the transition would be no different than any other time audit firms change.

But the second issue that arises is whether to allow Predecessor Firm to bid (and win) the non-audit services. If the Board imposes a rotation requirement with a period of time before the successor could return to the engagement, the Board will have to consider whether providing non-audit services during the interregnum ought to defer the ability to resume auditing the client.

There are two options the Board would have in such cases. One option is to say that the predecessor firm is not fully withdrawn from the audit client, therefore the "cooling off period" is not in effect. If the Board determines that after rotating off a client a predecessor cannot return to the audit for five years, the clock does not start on the five years until the predecessor has no interaction with the client.

The other option the Board has is to extend the period between audits by the predecessor. By way of illustration, suppose the Board passes a requirement for audit firm rotation after seven years of audits with five years before the audit firm can return to audit the client. The Board's requirement allows the predecessor firm to bid and win non-audit services for the client, however, the amount of time before rebidding and winning the audit work is extended by some factor. It could be one-to-one, year-to-year, meaning it would be ten years before the predecessor could audit the client. Another idea is that the period is extended six months for each year the predecessor performs non-audit services for the client. In this case, the bid could not be submitted for seven and a half (7½) years.

The chilling effect for auditors is that they would face bidding new work with little to no guarantee of winning work to replace lost fees. The larger firms, with offices nationwide, even worldwide, would have an easier time replacing engagements as they would all be in the same situation. Firm A basically passes work to Firm B, who passed on work to Firm C, etc. Eventually, Firm A picks up work passed on from the other firms. The problem is with the smaller firms that do not have that breadth to absorb work inflow and outflow.

9. If rotation were required, would audit firms have the capacity to assign appropriately qualified personnel to new engagements? If they do not currently have that capacity, could firms develop it in order to be able to compete for new clients, and would they do so?

Or asked another way, if Audit Firm X wants to bid on Government Contractor N's audit engagement, but the firm does not have any government contractors as clients, will the firm hire a partner, manager, senior, and staff in order to make a bid for Government Contractor N's audit? I would not. I would, however, seek to build a group that could do those engagements if my firm was in the right location, such as Washington, D.C., or New York City, or anywhere else there is a concentration of government contractors. Similarly, I might ramp up to win insurance company audits if my firm is near a high concentration of insurance companies.

The question is how many firms are willing to take that risk – and we are talking smaller firms that do not have the breadth of client industries to maintain staffing. Many smaller firms are "boutique" firms, specializing in certain industries.

10. Would rotation create unique challenges for audits of multinational companies? For voluntary rotations that have taken place, what have been the implementation and cost issues and how have they been managed?

I cannot speak to this. I hope the Board has ample responses among the letters and hearings.

11. Would increased frequency of auditor changes disrupt audit firms' operations or interfere with their ability to focus on performing high-quality audits? How would any such disruption vary by firm size? For example, would a rotation requirement pose fewer or more implementation issues for small firms than for large ones?

This is a question of timing. If the Board requires audit firm rotation, the transition would have to occur after the Form 10-K was filed, and perhaps no later than the filing of the second quarter Form 10-Q. This allows the outgoing firm to wrap up its work with the incoming firm having two quarters for interim work to become familiar with the new client before having to opine on Form 10-K. Yes, there would be an opinion on the third quarter Form 10-Q, and perhaps other filings.

The timing of the bidding process then comes into play. The client company would probably want to settle on the successor audit firm shortly after completion of the fiscal year. This gives the successor adequate time to plan for new engagements while they, too, are transitioning off clients.

Much of this transition will be handled by partners and senior managers. The work performed on issuer clients will be done by staff and junior supervisors. At least, this is how I imagine it would work. Regardless of the size of the firm, work continues at all levels. Partners and senior managers will have to perform their review of audit work

before signing off on the report. Nonetheless, the audits ought to be of high quality whether firm rotation is required or not.

If the Board opts for the rotation requirement, I would recommend that implementation be phased in to avoid all companies affected having to rotate firms all at once. That would be a hardship for all parties. The best way to address it is to essentially perform a drawing from among all the affected issuer companies. The first group would have to rotate in two years; the next group in three years; and so on until all issuer companies are covered. New publicly traded companies would have to rotate based on whatever the term decided is, such as five, seven, ten or more years. It is not perfect, but would prevent massive upheaval.

12. **Would audit firms respond to a rotation requirement by devoting fewer resources to improving the quality of their audits? Would firms focus more on non-audit services than on audit services?**

I should hope that audit firms would continue to improve audit quality since it stands to reason the Board would not stop reviews and inspections. Where there is a chance that firms alter their business approach is in the second question asked here. I do believe there is a chance that certain smaller firms, those with less than fifty publicly traded clients, will consider yielding audit services to larger firms.

This reflects on the costs involved with having to bid new work and transition from existing work on a near quarterly basis. It would also provide more certainty of fee revenue and cash in-flow.

13. **Would rotation have any effect on the market for non-audit services? Would any such effect be harmful or beneficial to investors?**

This is a double-edged sword. It has been my contention for many years that we certified public accountants are greatly undervalued compared to other professions. For years, audits were used as loss leaders to get a firm in the door. Once in, the firm performed additional services with greater margin. With Sarbanes-Oxley taking much of this consulting work away from firms performing audits, and adding the internal controls component, it seemed we auditors were finally getting paid what we are worth with the audit.

Therefore, it seems to me that if a firm were to give up audits, fees for the non-audit services would have to make up for the lost revenue. That leads me to believe that these fees would go up over time. The harm to investors is a reduction in net income and possible dividends.

14. **Some have expressed concern that rotation would lead to "opinion shopping," or that in competing for new engagements firms would offer favorable treatment. Others have suggested that rotation could be an antidote to opinion shopping because companies would know that they could not stick with a firm promising favorable treatment**

forever. Would opinion shopping be more or less likely if rotation were required? If rotation limits auditor choice, could it at the same time increase opinion shopping?

Opinion shopping can occur now. If Firm D is my auditor and I do not like what they have to say, I can put my engagement out to bid to all firms in the hopes that I can get favorable treatment. If Firm E says that they will promise "favorable treatment", I can engage them today (within the bounds of exchange and federal regulations). This favorable treatment can last any amount of time, true, but audit quality has to be maintained. The Board's review and investigation can mitigate this risk today.

As for rotation, I believe that opinion shopping becomes a greater threat because firms need to replace revenue. The Board's review and investigation would have to increase. Perhaps the Securities and Exchange Commission ("SEC") could assist by requiring all documentation related to bidding be available for review. This would include the request for proposals, bids, emails, letters, and any other pertinent documents to ensure no promises of favorable treatment were made. These requirements can be done now without firm rotation.

15. **What effect would a rotation requirement have on competition for audit engagements? If competition would be increased, how might that affect audit quality?**

Firms will have to replace lost revenue. In theory increased competition could drive down audit costs. This also has a cost to the investors. In order to earn a profit, the costs would have to be reduced on the engagements. This can include such things as using more first and second year staff; fewer audit procedures; reducing scope; fewer substantive tests; etc. Therefore, the Board's goal of audit firm rotation is potentially lost. Audit quality goes down

What if we factor in some smaller firms leaving the audit market and competition at some levels goes down. How might a larger firm factor this work in their business model? On one side, they see smaller issuer clients as a means to maintain a revenue stream and cash in-flow to make up for some larger issuer clients lost in rotation. What happens if the larger firm wins new work with larger clients? Will the larger firm drop smaller clients? They might do this now. We may see an inverse pyramid when it comes to competition for audit engagements from large clients to small clients.

16. **Are there any requirements the Board should consider to mitigate any risks posed by rotation? For example, are there enhancements to firms' quality control systems that might address such risks?**

The Board is ultimately concerned with greater audit quality. The Board lists some of these quality concerns in the Release. The question that I have to ask – and I do not have the answer – How many of the audits inspected by the Board's staff lead to a restatement by the client?

The Board quotes counterparts in the United Kingdom, The Netherlands, Canada and Australia, all raising alarm over professional judgment, professional skepticism, and the like. While on the surface it seems disconcerting that auditors are too cozy with clients, I might accept mandatory audit firm rotation if this release included statistics concerning restatements.

Recall that I mentioned professional judgment earlier in my response to question four. The inspectors may be looking at documentation without having the full context of the client relationship. Auditors have to work with their clients – that is how they keep them. Auditors have to perform their due diligence – that is how they stay licensed and registered. The Board's inspectors can direct an auditor to go back to a client and gather more information to cover an apparent deficiency, but at what cost to the client and investor? The auditor will continue to perform that extra work, and perhaps more in later years, in order to not have a deficiency from the Board. That means more work for auditors – more costs for clients. And at the end of the day, it comes down to one auditor's opinion of "sufficient competent evidence" over another's.

The Board could come out with very clear requirements for documentation. By that I mean that the Board establishes sample sizes, scoping, calculations for materiality, and the like. But that is not what I believe the Board wants to do, nor what auditors and auditees want. Another alternative would be to have all publicly traded companies pay into an audit pool from which audit firms would be paid. In theory the auditors are free to perform their duties without tether to the client. The client would not pay them directly. Of course, the audit firms would have to figure out how to divide up the funds in the pool. I do not believe the Board wants this either.

The bottom line is whether audits are effective and efficient. If there are instances of audit failures, major flaws causing restatements, criminal charges, bankruptcies and so forth, then perhaps rotation is the last resort. I am not aware of an increase in these issues. I urge the Board to continue to discuss the concerns with the audit firms to improve a mutually understanding of professional judgment.

17. **If the early years of an auditor-client relationship pose a higher audit risks than later years, should the Board require firms to provide additional audit supervision and oversight in the first year or two of a new engagement? Should the Board impose such a requirement for auditor changes even if it does not further consider requiring audit firm rotation? If firms are accepting new clients but are unable to perform quality audits for them until several years have passed, should the Board require enhanced client acceptance procedures? What impact would additional requirements of this type have on audit costs?**

    I believe that the risks are always present whether it is the first year of an engagement or the tenth. The reason is that audit team members change periodically. Most certified public accountants go to a large firm, stay two or so years, and then move into the private sector or smaller firm. Those who stay in large public accounting firms like to see some different clients and do not mind the long hours. These long hours and the pressure to

complete work on short deadlines is a risk unto itself. The risk associated with a new engagement is that the new auditor does not fully understand the client. This means the client could sneak some shady transactions past the auditor. However, if the audit firm has maintained some continuity in the team, that risk is mitigated. This means that a senior or manager has been working on the client for two or three years, and their review can prevent a problem.

As time passes, the risk may shift as client and audit personnel get to know one another better. This is not to say that they meet outside work, or go to each other's weddings, and so forth. What can happen is that the client personnel may lull the auditor into believing everything is fine, when in fact a ticking fiscal time bomb is right before the auditor's eyes and completely missed. Here again, more senior audit personnel can catch these issues in review because by the nature of their duties, they are not at the client nearly as often. I believe this risk is the risk that truly concerns the Board.

Firm rotation can mitigate this risk, but at a great deal of cost to many parties. It may be better for the Board to require audit team member rotations. In this scenario, not all members would rotate out at once. Members who are promoted may be able to stay in some capacity so there is oversight with the advantage of history and deeper understanding. With added duties on other clients, the supervisory team members are less influenced by client personnel. These people can also train and guide new team members. Moreover, the Board could advise firms to have a core of persons assigned to an engagement with other members who float in for a quarter, or a year, and then move on. Perhaps the Board would require that no one person perform fieldwork (that is, regularly go to the client for weeks at a time) for more than three or four years. Generally, promotions would cover this.

The cost impact with this suggestion ought to be minimal.

Any audit firm that is not capable of delivering a high quality audit in the very first year with a client, ought to stop performing audits.

18. If mandatory rotation were required, are existing standards relating to communications between predecessor and successor auditors sufficient? Should additional communications be required? For example, should the outgoing auditor provide the incoming auditor with a written report outlining audit risks and other important information about the company?

This is a tricky area. Consider that the Board has cited deficiencies in audit performance by registered firms. Would the Board then have to require a certification letter from the predecessor firm to the successor firm stating that the PCAOB inspections are adequate, and any identified deficiencies rectified? Would this letter have to indicate whether any of the deficiencies related to inspection of the audit for the client being rotated to the successor? The predecessor's report outlining audit risks may have been the subject of an inspection report. Does a predecessor auditor want to reveal that to the successor? The successor may be inclined to perform extra work to ensure the prior work was sufficient.

Now we run back into the clash between two (or more) opinions regarding professional judgment.

For efficiency's sake, I believe that any required rotation would have to include hand off meetings amongst the partners, senior managers, and managers on the engagement. Also included in these meetings would be client personnel who will be primary points of contact (POC). Notice I would include the POCs, not just senior management. I believe it is important to include the client personnel who will be in the weeds of the engagement.

19. Are there other audit procedures that should be required to mitigate any risks posed by rotation?

Audit firms will be following established procedures for any new engagement. So, then, what additional risk may arise simply because the auditor-client relationship was changed by rule rather than by normal business cycles? By this I mean that the client did not grow beyond the capacity of the audit firm. The audit firm did not grow to such a level that it had to shed clients. The firm did not have to resign due to issues with management. These are some reasons why a client changes audit firms or vice versa.

The Board raised the specter that audit work may become slipshod as the term ended and the firm was focusing on gaining new work to replace the work about to depart. Therefore, the successor auditor may need to perform procedures to look back to the prior year's financial statements to ensure nothing was missed by the outgoing auditor. Items that could have been missed are required disclosures, fraud, and errors and omissions, to name a few. The work on the audit is being performed by auditors, not the senior partners and marketing staff putting together the proposals for new engagements.

20. If the Board moved forward with development of a rotation proposal, should consideration be given to the recommendation for a cause restriction on the company's ability to remove an auditor before the end of a fixed term? Would such a provision be useful? Would there be unintended consequences of such a requirement? Should the Board work with the SEC on implementation of this recommendation? Are there other matters on which the Board should coordinate with the SEC?

The Board asked about opinion in question fourteen above. To mitigate this risk, if the Board did proceed with the rotation requirement, a concurrent prohibition on removing an audit firm before a set period of time may be useful. The Board would have to limit this prohibition. One reason a client may seek to replace an audit firm is the firm cannot maintain staffing levels. Therefore, the client is repeatedly answering the same questions, explaining the same reports, and detailing complex transactions. The burden in this case, however, would be on the client. The Board does not have the ability to pass a standard for clients, only the clients' auditors. The Board would have to coordinate with the SEC in this case.

The next issue is whether this prohibition would go both ways – the successor auditor would have to remain on the client for the same number of years, except in certain circumstances. The burden is on the auditing firm in this case.

There are other unintended consequences to a rotation requirement that I discuss next.

In my answer to the fourth question I mentioned fee acceleration as the end of the term approached to make up for potential lost fees. This may affect smaller issuers and their smaller auditing firms.

Where companies are located may decrease the number of firms bidding for the audit engagement, as I write in response to question seven. Issuers located away from major cities may face fewer bids for their work. Recall that registration fees for the firms are based upon the number of publicly traded companies they audit. One possibility is that a regional firm with forty-five issuer clients may be willing to bid on four or five engagements, however, if the firm wins all five, the registration fee jumps from $500 to $3,000. Moreover, what would the impact of professional insurance be? Insurance goes up each year as the pool of potential lawsuits (from audit failure) goes up with each successive engagement.

Question nine leaves a rather curious question unanswered when it comes to firms developing the capacity to win new engagements. The question is whether the Board would have to include restrictions on firms hiring auditors from competitor firms who worked on the client in order to win the bid. To put it bluntly, my firm wants to bid on Government Contractor N's audit. I know that Firm A has that work and is going to have to rotate off in one year. Would the Board allow my firm to hire the manager in order to state in my bid to Government Contractor N that someone they are familiar with will be the senior manager if my firm is selected? Perhaps it would not be so blatant. Perhaps it would be that I provide a list of personnel presently on staff who could be assigned to the engagement. Government Contractor N sees the name and determines that it is their former engagement manager.

21. What other transition issues might arise in the first year of a rotation requirement? How should the Board address these issues?

If the Board proceeds with the requirement, and takes the recommendation of phasing the rotation in over several years so that not all companies and firms are changing at once, it will help the transition. With any large undertaking such as this, there are always issues that arise that no one really expected. For example, suppose the number of small to medium sized firms that opt out of auditing issuers drops much more than expected? The Board may be faced with issuers who cannot find a successor auditor. (Those issuers would get an auditor, but will have to pay a premium and higher percentage of revenue compared to larger issuers.) This may not even arise in the first year. It may come about in the second or third. The Board could call a halt to rotation for a time, or rescind the requirement should this occur.

> Another possible scenario is that larger audit firms (not the "Big Four" or others at the top of the list, but those closer to the middle) buy smaller firms in order to gain instant credibility in an industry or market where the presence did not exist. This dilutes the competition and, again, issuer clients may find themselves paying more for their audit. I am not sure what the Board could do about this, other than rescinding the requirement.

I would like to leave the Board with something I have shared many times. The first thing we have to remember whenever we pass a law (regulation, requirement, etc.) is that criminals – by definition – do not care about the law. In essence, we can pass a law that says that it is illegal to lie about your financial condition, but we know people do it virtually every day. Embezzlement is against the law, yet folks are arrested almost every week for embezzling funds. The Board is defining high quality audits as audits performed by audit firms unfamiliar with the issuer client; they are supposedly not influenced by familiar client personnel. Over time, as the auditor and client personnel get to know each other, professional judgment and skepticism diminish. My experience is that having high quality *people* as my auditor (and I hope that I was considered a high quality auditor in my day) is the key to me. I like my audit team. I truly appreciate their candor and questions.

Auditors have been and always will be at the mercy of client personnel telling the auditor about a transaction or other important business fact. If an auditor wants to know why revenue on Job 7 went down this year compared to last, the client's explanation is what it is. Sure, part of the audit procedures may be to get a copy of the contract to see if, in fact, the work ended during the current year, but the client can still hide other facts associated with the work. For instance, maybe the contract ended because work was considered poor by the customer. What procedures could the auditor take to document that, other than writing to the customer for feedback?

Auditing is an art, based in some scientific method and mathematics. Music is the same. Learning how to sing takes practice, patience, perseverance, and guidance from someone who already knows how to sing and develop the voice. The math behind the notes, melody and harmony, chords and key, is constant. Still, I could no sooner compose a great song even mastering the math based on the math alone. Music is an art form and transcends math. In a similar fashion, auditing is an art. How well is an auditor trained to spot indications of deception? Does the auditor see a disconnect (or discord) between the way a transaction was booked and the way it was described? What research does the audit team perform on the client's business? Do the auditors view the client website? Does the audit team attend seminars and conferences that attract other companies in the client's business? What is the reputation of the company and those at the top? All this goes well beyond debit and credits, and no amount of firm rotation will get these questions asked unless the auditor is of high quality.

I thank you for your attention.

Respectfully submitted,

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Frank Gorrell, MSA, CPA, CGMA