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**Opening Statement of Jack T. Ciesielski**
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I thank the Board for the opportunity to present my views on the matter of auditor rotation. I believe the PCAOB is acting in the best interests of investors by challenging the status quo and searching for ways to improve the objectivity of auditors, which ultimately should improve the audit process and overall financial reporting quality.

Well-intentioned as it is, however, I don't believe that required auditor rotation addresses the root cause of objectivity problems within the audit profession. The root cause is that auditors' interests are aligned with management, and not aligned with the interests of shareholders. Simply changing the auditors every few years only treats the symptom of the problem, and not the cause. There is no guarantee that a new auditor will do a better job than a previous auditor and it is very possible that newly-installed auditors might not be effective in the early part of their stint. Rather than encouraging skepticism and increasing financial reporting quality, auditor rotation might actually work counter to investor interests. I recommend that the Board should try to align the interests of auditors with shareholders in more fundamental ways.

Auditors' interests are currently aligned with management's because of the "client-payer" model. Nominally, shareholders approve the hiring of an auditor based on the audit committee's recommendation. That's the extent of their involvement, however. The audit fee is paid by the company; the auditor is examining the work of those who pay him or her. The auditor is in the awkward position of retaining independence and objectivity while depending on management for acquiring knowledge of the auditee firm – without trying to alienate the managers. This doesn't necessarily foster an auditor attitude of "working for investors" – and it encourages auditors to extend their relationships with clients as long as they can, or until it becomes clear that their own interests may be harmed by continuing to serve an unacceptably risky client.

Note that the root cause of the objectivity problem is the client-payer relationship. This fosters a long-term financial interest in the client that can impair auditor objectivity, and gets in the way of working on behalf of investors. Staying for the long run can have its benefits, too: the auditor's experience and working knowledge of a client should increase over time. This is only an investor benefit, however, if the auditor is working strictly from their point of view.

This brings me to another reason for a misalignment of auditors' interests with investors' interests: the auditors aren't retained by a single party of investors. The composition of investor ownership changes by the minute. It may be difficult to expect auditors to feel allegiance to a shifting, faceless group of investors; they probably seem to act as a cohesive bunch only when there's a legal threat. Again, that's not a situation that will engender strong auditor-investor relations. What needs to be done is to change the model for auditor payment so that all the right parties to the audit process have the proper incentives and penalties so their behavior will benefit investors. To improve the objectivity of the auditing profession, there needs to be a more sweeping solution than mere auditor rotation. I believe this can be accomplished by introducing the insurance industry into the investor relationship with the auditor and issuer.

Consider a model where financial statement issuers would purchase financial statement insurance that covers investors against losses resulting from financial reporting misrepresentations. You could think of it as a guarantee by the insurance companies that the financial statements are fit for use by investors. By transacting with the insurance company, the issuing firm would have a direct interest in the quality of the reporting process: the more confidence the insurer can place in the financial reporting process of the insured, the lower the premiums they should need to charge the issuer. There is a tension between the issuer and the insurer that plays out in the price of the premiums, which incidentally, should be publicly disclosed. The insurer wants to minimize losses so as to preserve profitability of the financial statement insurance product and will charge what it needs to obtain comfort that it won't lose; the issuer will want to make its reporting as clean as possible in order to prove to the insurer that it deserves the lowest possible premium. This is a transparent, market-driven mechanism that rewards virtuous reporting – and the insurer effectively stands in the shoes of the investors.

Insurers are already willing to provide insurance against risk of loss from events over which they have no control whatsoever. In offering financial statement insurance, they'd be insuring events where they could actually exert influence on the outcome of events. The insurer would gain comfort about the reliability and suitability of the financial statements because they would be the ones to hire - and pay - auditors to act as their agents. Auditors wouldn't have to worry about currying favor with an auditee firm's managers to insure a flow of future revenues: they'd be more incentivized to provide a high degree of audit assurance to the insurance company that hired them. The insurer, not the auditee, would be the source of the auditor's future revenues, so acting in the insurer's interests – and investors' interests – would also be good for the auditor. The issuing firm being audited would be highly motivated to work with the auditors, because their premiums for financial statement insurance would be directly affected by their cooperation with the auditors.

The proposed model provides further incentives for auditors to perform high quality audits. It would be likely that one auditing firm might be retained by one insurer for many audits. A sub-par audit causing the insurer to pay unacceptably high claims could damage the auditing firm's relationship with the insurer and cause a loss of revenues far beyond those stemming from one sub-par audit. Contrast that to the current consequences of a substandard audit: scattered investors are rounded up by the legal profession into a class of litigants and take the auditor to court, which is an inefficient process. If the court finds for the plaintiffs, the auditor faces economic penalties related to that single audit. The reputation of the auditor may be sullied somewhat, but the auditor doesn't generally lose other audit clients because of the failure of one audit. Facing the threat of losing revenue for many audits as a consequence for doing a poor job on just one engagement would be a far more powerful auditor motivation than legal consequences.

In short, the proposed insurance model would provide proper incentives and penalties for all parties to report more effectively for the benefit of investors. While I commend the Board for taking a big step in considering auditor rotation, I strongly encourage the Board to "think bigger" and give serious consideration to the more sweeping reform potential of the insurance model. I believe the Board will find that investors would be interested in this model if it was given more attention. For example, it is my understanding that the CFA Institute also supports exploration of the insurance model as an alternative to the client-payer system.

I would be happy to take your questions.