Office of the Secretary

PCAOB

Reference: PCAOB Rulemaking Docket Matter No. 37, Auditor Independence and Audit Firm Rotation

This letter represents a long form response to the PCAOB's request for comments. The first 20 paragraphs were sent separately both in hard copy and in email form. This letter adds several additional observations and comments as well as attempts to answer the specific questions posed by the PCAOB in brief form.

I appreciate the efforts of the PCAOB to enhance audit quality and to broaden understanding by the investing public. The PCAOB goal to protect investors is an element of the fiduciary objective of a Company's Board of Directors and its Audit Committee, at least in the US. Outside the US, Boards and Committees operate differently by both general practice and law/regulation, and academics seem to have undue influence on regulators.

The Concept Release points out many on-point negatives to mandated auditor rotation. I agree with all of them. They should be sufficient to quash the rotation mandate being proposed by the PCAOB. I would add that the requirement would be equally disruptive and costly in time and distraction to management, Company staff and the Board. The focus on business operations and shareholder return would be diluted by the auditor rotation exercise and its effects, exposing whether shareholder interests were best protected. Delaware law states that the Board's primary responsibility is to act in the best interests of the Company and its shareholders. Taking the operating responsibility of auditor selection out of the hands of the Board may create legal issues and confuse shareholder expectations.

Yet I recognize that some have a poor perception about whether auditors are really independent; some have real concern about their independence; and some seek more transparency about relationships and history with the external auditors. As a result, I offer some other approaches, singly or in combination, that may appropriately be considered to better address those needs.

I believe that relating the complex background of well publicized large company failures and the PCAOB's experience in categorizing "audit failures" in audit firms' examinations to an independence problem with independent auditors that might be cured by audit firm rotation is a leap well beyond any supportable facts, certainly insufficient to warrant a
costly and problematic conclusion such as the proposed mandated auditor rotation. The reasons put forth to justify such a requirement are insufficient to make the changes proposed/considered.

The "SOX" legislation of 2002 placed significant and new responsibility on the Audit Committees of Boards of Directors of public companies. It greatly changed the dynamic of the auditor relationship as well as, in many cases, that between the Board and management. The Audit Committee ("AC") became the contracting party in engaging independent auditors to review financial statements and/or performing other services to the registrant. The role changed from advisory to management to primary. Taking decisions such as the selection of auditors away from the group best or better informed about company needs, complexities, controls, internal capabilities, historical relationship with the CPA firm, capabilities of the firm, confidence, trust, etc, appears misguided. And it expresses no confidence in the job that most if not all Audit Committees have performed in a significantly different and better way over the past several years.

The PCAOB's release noted that Cohen Commission in 1978 "recommended against mandatory auditor rotation and concluded that the audit committee is in the best position to determine whether rotation is appropriate." The SEC supported that conclusion again in 1994. SOX moved that positioning further forward several strides. It's changes were powerful. I believe such changes have been particularly profound when CPAs have been members of ACs. When SOX was developed, former Chairman of the SEC Harvey Pitt agreed with the Cohen Commission conclusion. Post SOX, the AC owns the relationship with the audit firm. Directors are elected directly by shareholders for a reason. Shareholders can express their views via that process. Director roles and responsibilities to shareholders are defined by practice and by law. Increasing the credibility and understanding of the audit in the public mind, if and as needed, is not an independence issue. Rather, the "expectation gap" is an investor education and auditor scope issue. If auditors are deemed to need to expand procedures, re-define GAAS. Independence cures might focus greater attention to the directors not the auditors.

I personally do not believe the PCAOB has received enough input from AC members or chairs. As an active AC Chair, I attend numerous seminars for CPE, read all manner of Board publications, read or participate in business press, NACD, law and accounting firm updates, webinars, conferences, surveys, etc. The changes since SOX seem compelling, yet appear not to be adequately recognized by the PCAOB. My opinions have not been sought in a fashion that is practical. And certainly most AC voices are quieter than outspoken critics who enjoy getting press or narrow constituencies that have another agenda. AC members are working to fulfill their responsibilities, not writing letters or getting interviewed. I encourage the PCAOB to get AC input regarding post-SOX changes, and their effects on control over the audit process and auditor independence

In any case, I have several suggestions and further observations on the points/questions
you raise. I also start with a premise that most professional individuals working for a CPA firm or responsible for preparing financial statements for registrants operate with a certain professional ethic and moral compass. Auditors and registrants generally have the same focus in collaboratively seeking fair presentation of results and disclosures. There have certainly been unfortunate exceptions to that premise, but the lowest common denominator should not necessarily drive regulation. While the professional skepticism required of an auditor is important to the audit process, only a minority of the investing public starts being skeptical about auditor independence or the quality of financial reporting. Most have faith, based on far greater positive experiences than negatives. So the objective should be how to best and efficiently control the outliers—the failures, the frauds, the scope misconceptions—and not take reasoned judgment out of the process. Another premise of mine, based on real-life experiences not necessarily known to those skeptics or rotation advocates, is that major accounting firms believe very strongly that no client is too big to walk away from, that accumulated profits from the most desirable or largest accounts is not equal to the cost of an audit failure and related litigation or damaged reputation.

1. The focus should be first and foremost on the AC. Some expansion of the financial capability and acumen requirements to be a member or Chair of an AC, or for the majority of AC members, may be helpful and warranted, to ensure greater ability to oversee and hold accountable the external auditors, internal auditors, and financial management. Overseeing the financial functions as a COO or CEO may not be sufficient to understand the nuances of accounting, financial reporting and disclosures nor the operations of internal auditors or the profession of public accounting and auditing. The requirements as they currently exist may be too broad to accomplish an intended or improved result. While many non-CPA AC members or Chairs without direct CFO or CAO experiences do an excellent and thorough job in their roles, some of the public company frauds and failures have had ACs without, in hindsight, requisite skill sets. While not seeking the near-term replacement of existing AC members or Chairs, when qualifications or performance might be in question their successors or fellow members perhaps should have to meet more stringent financial capability requirements. The proxy statement from the AC might be expanded to document the financial capabilities of the AC and perhaps justify its composition. Some rotation of members within or among the AC and the Board might also be mandated or encouraged as "best practice".

2. ACs should be mandated, or encouraged by "best practice" guidelines, to periodically evaluate rotation of the audit firm, at least every 10 years, and to address this evaluation in its proxy statement. The evaluation is NOT to be interpreted as an assumption to rotate. The AC evaluation of the capabilities of the firm and assessment of independence would be part of that dialogue. Successful audit firm relationships of 50 years or more have existed without issue of any kind. In many cases, critical information on issues, problems, fraud, errors, background, etc. is obtained via a stellar communication relationship developed
over many years that completes the audit process. So familiarity (apparent "coziness") can be a good thing, not a bad one. It need not adversely affect professional skepticism and audit quality.

3. The AC should be encouraged by best practice to evaluate every 3/5 years the engagement of another firm of audit and accounting consultants, reporting to the AC, on audit and accounting and financial reporting and disclosure risks within the registrant. The need for and accomplishing this task should also be addressed in the AC proxy report. The scope, depth and focus of the engagement is to be determined by the AC, based on their own comfort with the actions and capabilities and communications with external and internal auditors and financial management, with the objective being to absolutely ensure that any and all issues are on the table for evaluation.

4. The focus of my comments next shifts to the Audit Firm.

A. I suggest strong consideration to revising specific audit partner rotation rules, lengthening to 10 years for the lead partner, but shortening the rotation of the National Office-assigned review partner to 3/4 years. Too much knowledge and benefit was lost by reducing the pre-SOX 7 year rotation requirement to the current 5 year requirement. Audit costs rose as a result, disruption to trusted relationships and communications were impacted, lives and career paths of audit professionals and the quality of audits were changed not necessarily for the better. Limiting the review partners from becoming lead partner upon rotation is also inefficient and detrimental to audit quality objectives. A "cooling off period" should only be a requirement for the lead partner, and National Office must be responsible for the quality reviewing partner assignment to overcome any potential local office prejudices. The Board and audit committee build a relationship with the lead partner that enhances AC oversight of the financial reporting processes and people within the Company. The credibility of the lead partner is important and should not be discarded lightly in the post-SOX world. It was only an occasional problem in the pre-SOX world.

B. All external auditors, staff through managers in particular, annually need to have emphasized their ethical responsibilities as CPAs (or working for a CPA firm), the firm's "whistle-blower" like practices and procedures and confidentiality, and an appreciation for the perception of its role as public watchdog for investors.

C. When a company changes auditors, the departing firm should be mandated, with "safe harbor" protection from confidentiality or slander standards, to communicate to the successor all important points-of-view the predecessor has or had about the company's risks and exposures, the company management of same, historic conflicts of opinion, unresolved conflicts, and management integrity. The successor firm must document, through an appropriate National level, its evaluation of these communications and its confidence in its ability to address such risks as part of client acceptance.
D. The depth, breadth, quantity, technical expertise, experience and local office independence of the concurring/review partner(s) needs to be evaluated and documented against some to-be-developed standards related to total fees, new or pending IPO, profitability, stock multiples or volatility, and international breadth and geography. This would formalize a practice largely considered by most firms and firm divisions presently. Having a lead review partner and supporting cast of other partners or managers might not be unusual. Having audit firms invest more in this effort and its execution can be a very significant backstop in ensuring audit quality.

E. Lastly, a further supplemental review, at the start of or shortly before the year-end audit work begins, of audit scope and extent of testing might be helpful on complex or targeted audits. A local office auditing technician can do this through review of the audit planning memo, discussion with the audit team about issues and results to date, and, as needed, review of the audit programs. National industry advisors could be involved as deemed appropriate by the firm or the technician.

5. The PCAOB should, in its study of Audit Reports, evaluate the modification of reporting standards to again permit the use of "subject to" opinions. Whether and how this may be better than "matter of emphasis" paragraphs needs to be a critical part of the evaluation. The objective would be similar, but focus on the auditing difficulties as opposed to disclosure matters. It may still accomplish the objective of highlighting valuations that are very difficult to evaluate or quantify with a considerable degree of accuracy or certainty (or other very subjective areas or areas very broadly impacted by future operations). The objective seems to be to point out to users the issues and disclosures that need to be read and considered, sharing in some efficient way the key audit risks and valuation difficulties. An "auditor's discussion and analysis" is not an efficient way to do so, and shifts inappropriately the burdens of disclosures to the auditors. Emphasis paragraphs may also place the burden incorrectly for disclosing risks and uncertainties. That responsibility rests with management. If emphasis paragraphs are used primarily for cross reference to key footnotes or paragraphs, their use may be helpful but unfortunately diminish the importance of all other footnotes. How much audit scope to unveil in presumably informing investors about valuation or recovery or liability audit approaches would be a challenge in assessing value. Audit programs are hundreds of pages and audit planning memos can be 25 to 100 pages. Keeping some secrecy about audit scope used to be desirable to ensure management could not devise plans to circumvent testing or hide transactions. The ongoing year after year quarter after quarter dialogue between auditors and the AC make scope review practical at that level, not for a new or periodic or annual reader. The political issues between the registrant and its auditor on emphasis paragraphs or opinion modifications need to be addressed, so that such uses become more standard and their mere presence does not adversely affect the market's perceptions of the company.
Audits are not insurance nor guarantees. The investing public needs to be better educated about the imperfect and testing nature of auditing and asset valuation, and the perspective of historical point-in-time conclusions vs. being able to predict future outcomes. Some concept of "caveat emptor" needs to be restored in our courts as opposed to always protecting individuals from themselves.

I believe I have a voice that should be considered. I worked in public accounting for 35 years, with Ernst & Young, in 3 different cities. I served as audit partner on many registrants, in and out of the financial services industry. I also played a significant role within E&Y as an "independent reviewing partner", as they were known at the time, on many registrants and IPOs, particularly in the insurance industry. I retired in 2003, and have served as a member or Chair of two audit committees of registrants, one a NASDAQ company and one listed on the NYSE, both insurers, and one mutual insurance company. I well understand the operations of CPA firms and audit committees, and the needs of investors. I follow closely the activities of the PCAOB and the Board and investor community at large. And I appreciate the opportunity to share my opinions and observations.

Some newly presented (vs. my prior letter) observations/opinions on the material in Release No. 2011-006:

Having the same auditor for 50 years does not have the same inference about auditor independence that audit firms doing certain management consulting, internal audit, or actuarial services did, in that the latter blurred the relationship between management and the external auditors. Thus establishing parallels to the SOX limitations on services and their lack of empirical evidence does not automatically translate to or is relevant to these questions.

I might add a bit of perspective as a former auditor. The Release suggests that an audit firm using in a proposal the words "partner with", "support the desired outcome", and "not second guess our joint conclusions" infers an independence problem. While I may not choose the same words, this inference ignores the fact that, most always, the audit firm and management are working collaboratively to get the best and right answer, the first time, producing the right answer that both reflects economic reality and is in accordance with the accounting rules. An auditor generally and thoroughly works with management to get it right. I acknowledge that I do not have the context of those illustrations, and context is important. While accusing the auditors of bias towards client answers and decisions, this material shows some PCAOB bias in the independence question. It
seems to be a cheap shot. Semantics in a sales document does not in any way imply a major firm is planning to compromise its principles. The Release uses "may" an amazing number of times, attempting to infer an issue from some point. That speculation seems quite prejudicial to me. Addressing the "client payor model", the Release notes a "basic conflict that too often proves difficult for auditors to overcome", which is just not borne out by history, in the sheer quantity of what I would call "successful audits" vs. company or audit failures. And auditors need to establish strong and open relationships with client personnel to enhance the communications up and down the lines of individuals doing or overseeing work, in order to get access to information and observation that facilitates the audit.

I couldn't disagree more with John Biggs point of view, or the PCAOB's continuing to quote him so many years later after innumerable changes to practices. His suggestion was an antidote that is costly and inefficient and unproven as to necessity or desirability. I was an auditor. He was not, yet he is mind-reading for a profession with a generally outstanding ethical history. TIAA-CREF has been an outlier on the rotation issue; few others agreed with that approach. The internal fresh viewpoint from partner rotation and my reviewing partner's annual work was more important than a threat of an external one in the future, as it affected my performance evaluation within the firm. I might never know about a successor firm's point on an issue that did not mandate restatement. Changes in the role of the AC and Board, AA's culture and staffing, whistleblower emphasis, and the tone at the top of Enron MAY have had a significantly greater and efficient effect than the threat of auditor rotation. I agree that SOX changes make many of the historical perspectives less relevant, yet feel history is overly used in the document addressing the proposal and not enough is presented on post-SOX changes.

In response to the specific questions posed:

1. no rotation mandate at all; greater than 10 years is no better answer than 15; 5 years is ridiculously cost prohibitive. Would rotating every year be even better if cost and audit quality are subordinated to other more practical considerations?

2. no; a fraud or an audit failure can take place anywhere anytime any size, and all elements of an investing public should be protected if any are by such a costly and
unnecessary dictate. Some frauds are in the first few years after an IPO; fewer are within long-established stable companies; recent frauds or company failures have been in financial services; in other periods it was high growth service companies, real estate operations, etc. If the PCAOB is going to be oblivious to the cost and distraction and inefficiencies of auditor rotation, then all registrants should be similarly impacted not a chosen sample or isolated targets. SOX-like exceptions should not be granted.

3/4. my public accounting experience has shown that auditor effectiveness is most diminished in a year before change (has been voluntary change) when the departing staff, particularly at the lower and intermediate levels, knows the relationship is ending and perform without enthusiasm or proper attitude or incentive. They work less, inquire less, pay less attention to detail, engage the client less, etc. New auditors do dig in the first year, with enthusiasm and energy, and generally feel less constrained by cost overruns vs. budget. But without a base of knowledge, there is risk of not seeing something or asking the right questions or having the trusted relationship to get to the heart of a matter. Experienced auditors perform at the same level of diligence; if they believe they have reached the correct conclusions historically, as they generally do, second guessing by another firm or a successor is not a factor.

5. if the mission of rotation is to supposedly force independent thinking and have it "proven" by a new firm "second guessing" prior decisions, then that would be accomplished in one year. As business economics is not being considered, what would be gained by having any extended period before allowing the previous firm to be re-engaged?

6. answer should be the same as #2 above. a fraud or an audit failure can take place anywhere anytime any size, and all elements of an investing public should be protected if any are by such a costly and unnecessary dictate.

Questions 7 to 15 are best answered by the accounting firms themselves. But my opinions not always based on facts are:

7. no choice limitations; big firms have all skill sets and experience and can place staff in the needed location; uncertain about the effects on small firms.

8. some companies do already use all major firms for some work, and the rotation
mandate could limit the choice of auditors. Since some services deemed to impair independence were prohibited based on appearance as much as fact, the dictate regarding time to cleanse one's firm can just as easily be overruled by a "regulator".

9. yes on all counts.

10. yes, significant challenges because not all firms have all resources everywhere around the world, particularly industry specific or expertise. Firms have been willing to move many resources to different locations to obtain a potentially long lasting relationship with a large multi-national company, and those costs in the past have not always been passed onto the client.

11. Very disruptive to firm's HR and business operations and profitability. The current 5 year rotation rule for partners has greatly changed the dynamic regarding transfers within firms, as many times the engagement partner becomes a commuter vs. moving to the new client city, thereby affecting their personal life, creating outside strains that can affect performance, and inhibiting relationship building that could be critical in overseeing staff and obtaining trusted insight and information from client sources. If the audit itself were to be rotated, no one may ever risk a move, limiting a firm's ability to develop talent or staff knowledgably. Many auditors join smaller firms to limit the likelihood of transfer; participation in the audit rotation process may cause quality staff to leave. The same may be true for larger firms, as the uncertainty about a firm's portfolio of future clients makes an uncertain career path.

As mentioned, a rotation requirement is equally disruptive and costly in time and distraction to management and staff and the Board. The focus on business operations and shareholder return is diluted by the auditor rotation exercise and the "training" of new teams in company processes. There are better ways to get better results. Most financial staff are already some of the hardest and longest-hours workers within a company. They too will resent the distraction and interference in their activities, which could affect audit communications and quality as well as care in the financial reporting exercise.

12. no, and yes.

13. uncertain
14. **opinion shopping is a thing of the past, certainly among the Big 4.** Communications, National oversight, ethics and professional practice requirements, and SOX have all changed the landscape.

15. anything that inhibits profitability of firms risks impeding audit quality. the motivation to reduce fees means reducing hours reducing potentially audit quality. The AC should be monitoring the adequacy of auditor fees as a surrogate for profitability to ensure no impediment to a quality audit effort. The AC surely should be partners with the audit firm in getting the best and right answers fully yet efficiently in the financial reporting arena.

16. suggestions made in the body of my response.

17. the PCAOB cannot do all things for the accounting profession. Keep the government out of places where the private sector is a better source. The auditing profession should remain a private sector operation vs. a government function using regulatory employees (an impractical solution and not a desirable career path for all those currently in public accounting, thereby affecting quality of personnel in the field). The PCAOB cannot set audit scope, extent of team management and review, business practices, etc. The current audits are designed to be an efficient yet sufficiently complete process to meet the audit's objectives at a reasonable cost. Further interference in the day to day operations of private firms can only disrupt that and greatly increase costs. I have included a suggestion about new client acceptance related to predecessor/successor communications in my comments.

18. see sentence above.

19. such a general question to be unanswerable.

20. such a provision is another step leading to the PCAOB assigning auditors to registrants vs. having the AC select them based on an informed needs analysis and judgment about the best capabilities to get the best yet most efficient answer.

21. such a general question to be unanswerable.

I appreciate the opportunity to respond. I appreciate any consideration you may give to my opinions and experiences.
Very truly yours,

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