Governance for Owners USA Inc

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December 30, 2011

Public Company Accounting Oversight Board
Attention: Office of the Secretary
1666 K Street, NW
Washington, DC 20006-2803

Docket # 37, CONCEPT RELEASE ON AUDITOR INDEPENDENCE AND AUDIT FIRM ROTATION
PCAOB Release No. 2011-006

Dear Mr. Secretary:

We are pleased to comment on the PCAOB proposal on auditor independence and audit firm rotation. Governance for Owners USA, Inc is a specialist in adding long-term value to publicly quoted equities by means of shareowner engagement and good stewardship techniques. Our parent organization is London based and, therefore, we have a global perspective on major issues.

As an investor and advocate of good corporate governance, we support the policy of auditor rotation. If the PCAOB does not wish to move to such a policy at the present time, however, it should at least consider a policy of auditor retendering—that is, periodically seeking bids from other audit firms that meet the audit committee’s eligibility standards. Investors are quite concerned about the independence of audit firms. The tender/bid process and periodic firm rotation will improve auditor independence. As long as company management pays the audit fee directly to the audit firm, there will always be concern about the independence of the auditor. We acknowledge that many companies have strong audit committees that provide the appropriate level of independence that should satisfy investors. Nevertheless, it would be mistaken to assume that all companies have such strong audit committees and many investors do not accept that broad assumption. Under current disclosure rules, it is extremely difficult for investors to determine which companies have the proper level of independence. Thus, the PCAOB should consider ways in which investors can be assured that the audit is performed with the utmost of independence, including the current tenure practices of company/auditor relationships.

Long-term relationships between public companies and audit firms, such as those lasting 50 years or more (such examples exist), raise substantial concerns to investors about the appearance that the auditor might be less
independent than necessary to provide a high-quality audit.

Some of the initiatives brought about under Sarbanes-Oxley have addressed auditor independence and likely have improved independence. Specifically, the PCAOB’s role in writing audit standards and the inspection program are improvements in the audit process. In addition, the expanded role of the audit committee has improved investors’ views about the relationship between company management and its auditors. However, with company management continuing to pay the audit fee, other avenues fostering independence of auditors must be pursued.

It is a common practice in the not-for-profit and the governmental sectors to rotate audit firms periodically. The appearance of “favoritism” in those sectors likely led to the practice. That same principle could have application to all sectors, to provide the further appearance of independence.

Rotating audit firms might provide more opportunities for non-Big 4 audit firms to audit in the public sector, although this does not seem to have happened as of yet. This is an area that ought to be studied by the PCAOB to encourage greater competition.

How often should the audit firm be considered for change to achieve the goal of increased independence? There is no magic number, but some number around 10 is probably workable, and certainly less than 20 years. We suggest consideration of compulsory retendering every 5-10 years with a rebuttable presumption of change every 10-20 years. If there were no change, better disclosure of the audit committee decision should be required.

There are claims that the quality of audits will suffer because of firm rotation. We see no evidence of that. We have confidence that a transition to a new firm can be worked out in a professional manner that would not decrease audit quality. The PCAOB staff has more intimate knowledge of audit quality and can address any potential concern in its rulemaking. Anecdotally, investors were unaware of significant audit quality declines with the “forced rotation” of all Arthur Andersen firm clients.

Will the costs of an audit go up if the audit firm is rotated periodically? We do not anticipate, with competition, that audit fees would increase significantly. However, some minor cost increase would be acceptable to most investors for the benefit of increased auditor independence.

I should add that in my former employment as Chief Investment Counsel for TIAA-CREF, we had a successful audit firm rotation policy that in our view improved audit quality and did not raise costs. As an investor, we sought to “quietly” encourage portfolio companies to periodically rotate audit firms with no takers. This experience reinforces our view that little if any changes in audit firm retention will take place without the impetus of the PCAOB.

We would be happy to discuss my comments further if that would be helpful to
the PCAOB.

Sincerely,

[Signature]

Peter C. Clapman
Chairman, Governance for Owners USA Inc.