April 3, 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. 037
Concept Release on Auditor Independence and Audit Firm Rotation

Dear Board Members,

I appreciate the opportunity to comment on the Concept Release on Auditor Independence and Audit Firm Rotation issued by the PCAOB in August 2011.

I have spent a lifetime working to create systems that promote sound financial reporting and the kind of productive auditor skepticism you describe in the Concept Release. I spent most of my career with Ernst & Young, LLP, first as an auditor and ultimately as Global Vice Chair. More recently, I have served for seven years as Chair of the Audit Committee of SVB Financial Group, and later this month will step into the role as Chairman of SVB’s Board of Directors.

I share the PCAOB’s interest in promoting auditor independence, objectivity, and professional skepticism – as does SVB. Every public company depends on the integrity of our country’s public equity markets, since all companies suffer when investors lose confidence in the accuracy of financial statements and disclosures. SVB has a particular interest in supporting efforts to ensure sound financial reporting, given the importance of accurate financial statements to a lender.

That said, I do not believe that mandatory audit firm rotation will promote the PCAOB’s objectives. I therefore urge you not to proceed with this proposal, for the following reasons.

First, the proposal for mandatory audit firm rotation rests on an unproven assumption – specifically, that “[b]y ending a firm’s ability to turn each new engagement into a long-term income stream, mandatory firm rotation could fundamentally change the firm’s relationship with its audit client and might, as a result, significantly enhance the auditor’s ability to serve as an independent gatekeeper.” Release at page 9 (emphasis added). According to the Concept Release, the PCAOB has found several hundred “audit failures” during its review of more than 2,800 audit engagements. It is unclear, however, whether these shortfalls directly arose from a lack of independence or that a lack of independence led to financial misstatements. An array of checks and balances already exist to ensure that audit firms and their clients work diligently to avoid the risk of audit failures and financial misstatements, including audit partner rotation, review partner rotation, Audit Committee responsibility for the audit engagement, limits on an audit firms’ ability to provide non-audit services, and PCAOB oversight of audit firms. There is no basis in the record to conclude that the additional measure
discussed in the Concept Release would reduce the number of audit failures or improve the quality and accuracy of financial reports.  

Second, even if the premise were true, mandatory audit firm rotation will not eliminate a firm’s desire to develop long term relationships with clients. In fact, it may make matters worse by forcing firms to scramble every few years to convert audit clients into non-audit clients, and vice versa.

Third, I believe the Board’s proposal understates the serious problems with audit firm rotation resulting from the limited number of firms available with sufficient scale and industry expertise. Currently a company’s existing auditor and internal auditor would be excluded from consideration, and firms with prior employees on a company’s board may be excluded, thereby limiting consideration between the existing audit firm and only one other.

As the Concept Release acknowledged, several studies have documented the higher peril associated with new audit clients. Auditing a company’s financial statements and internal controls requires a deep understanding of the client’s business, its key accounting policies and assumptions, its internal control structure, and the strengths and weaknesses of its management team, as well as a strong, open and honest relationship with its management, Audit Committee, and Board. The necessary expertise and candor cannot be established overnight, and without these even the most well intentioned (and independent) auditor is working with one hand tied behind his or her back.

Moreover, there are only a handful of audit firms capable of serving large clients, and these firms vary in their areas of sector and geographic expertise. These problems are compounded by the fact that publicly traded companies may not rely on the audit firm to provide material non-audit services. As a result, mandatory rotations will not result in an open marketplace ... but they will be enormously complicated and destabilizing. Companies will have to coordinate engagements across substantive areas (audit, tax, internal audit, compliance, etc.) and across geographies. Any shift in the audit firm will cascade across all engagements, forcing companies to up-end their structures for both audit and critically important non-audit services every few years. While the current system admittedly may give qualified incumbent firms a “leg up” on continued audit engagements, it is entirely possible – even likely – that under the proposed regime audit firms will be able to predict with a high degree of certainty who is “next in line” to audit a given company, given the limited number of options and the company’s past and current audit and non-audit engagements with qualified firms. And it is even possible that companies will be unable to maintain independence for enough firms to obtain high quality, independent audit services – with the specific sector expertise they require – at the time of each rotation.
In addition, while it is possible that mandatory rotation could increase independence and thus improve audit quality, it is equally possible that mandatory rotation could lead firms to devote less attention to “lame duck” clients and thus weaken audit quality.

Finally, studies have shown that audit firm rotations meaningfully increase costs – and if mandatory firm rotation creates a seller’s market, cost increases could be even higher. Were there clear evidence that mandatory audit firm rotation would improve the quality and transparency of financial disclosures, those costs might be warranted. This, however, is not the case.

Over the last decade, U.S. listed companies have improved the integrity of financial reporting in a number of very important ways. I do not believe the additional step proposed in the Concept Release is warranted or will have the desired effect. For those reasons, I urge you to decline to proceed with this proposal.

Sincerely,

Roger Dunbar
Incoming Board Chairman
Audit Committee Chair
SVB Financial Group