

Dennis Fitzgerald, CPA
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Office of the Secretary, PCAOB
1666 K Street N.W
Washington, DC 2006-2803

Re: PCAOB Rulemaking Docket Matter No. 37 – Dennis Fitzgerald Response

Dear PCAOB:

This is my first response to the PCAOB's request for comment. Should my responses below not provide sufficient detail or require clarification, I am available to speak as may be convenient.

- 1) If the Board determined to move forward with development of a rotation proposal, what would be an appropriate term length?
 - * Recommendation is that assignments be limited to five (5) years which would ensure a sufficient tenure to understand and support the client in addressing the risk elements specific to both the client and its industry.
- 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?
 - * With the continuation of both vertical and horizontal integration (i.e., media and high tech; fossil fuels and green energy, etc.), there should not be varying engagement terms as the external audit firm should be an ongoing part of M&A activity and should be prepared for changes in audit scope that come through either acquisition or divestiture.
 - * In the event of an acquisition and thus a scope increase, the audit firm should be able to withdraw from the engagement due to a lack of capacity and/or capability.
- 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?
 - * The suggestion that time and experience make an audit more efficient and effective does not seem plausible as under that scenario, audit fees should be the inverse of the learning curve. It is unlikely that any firm sees a marked decrease in the audit fees charged over time by continuing with the incumbent audit firm.
- 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 be 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?
 - * Similar to the threat of PCAOB inspections, it would seem an audit firm would be more diligent in its work and in managing its product, knowing that another firm would be engaged within a given period (i.e., 5 years). More importantly, it would move the audit industry to a more consistent approach to audits as firms review prior audit work and look for common and best practices.
- 5) How much time should be required before a rotated firm could return to an engagement?
 - * Similar to Point 1 above, there should be a five (5) year "cooling off" period.
- 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 to audits of companies in certain industries?
 - * As Sarbanes-Oxley drew a line of \$750 Million market capitalization, it would seem a similar approach is warranted. However, my thought is that significant investors (i.e., institutional) become exposed with firm market capitalization starting at \$5 Billion.

- 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?
- * To maintain competitiveness and audit market resiliency, it would seem that client firms should maintain an open competitive process in hiring their external auditors. Audit firms are supposed to bring independence and an open mind to their clients. If client firms are "biased" to specific audit firm skills, there is a risk of complacency and insufficient depth due to an audit firm starting with pre-conceived perspectives.
- 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?
- * Recommendation is that non-audit services are concluded/transitioned within six (6) months of the firm being hired for an audit engagement.
- 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?
- * As noted in Point 6 above, the rotation program would apply only to firms with market capitalization greater than \$5 Billion. It is unlikely that smaller firms would have the capacity of capability to address audits of this magnitude. The major audit practices would have the capacity to draw from both their domestic and international personnel to properly address staffing requirements.
- 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?
- * As noted in Point 9, I do not see this as a challenge for multinationals. As for the second question, the fundamental question is how best to protect the shareholders, NOT how best to manage approximately \$2-3 Million in potential Year 1 cost increases, which should dissipate over the life of the engagement (over a five (5) year engagement), that averages \$400-600 thousand which, for a firm valued at \$5 Billion, may get lost in the rounding).
- 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 question was probably answered back in 2002 with the demise of Arthur Andersen. Somehow, the audit firms were able to absorb a 20% (estimate) increase in their portfolio of clients.
- 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?
- * Recommendation is that the QC partner comes from a different firm to ensure independence and objectivity. The QC process is a critical component of any audit. It has never been clear as to why the QC work is performed by the same firm that performs the audit. How likely is it that the QC partner will find one of his/her peers as ineffective in an audit, especially if the client may become aware and incur incremental costs?
- 13) Would rotation have any effect on the market for non-audit services? Would any such effect be harmful or beneficial to investors?
- * I don't see an impact to non-audit services. If anything, it may open the market more broadly.
- 14) Some have expressed concern that rotation would lead to "opinion shopping," or that in competing for new engagements firms would offer favorable treatment.⁹³ 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.⁹⁴ 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?
- * Knowing that the audit firm is rotated and that prior audits will be reviewed, there would be little long term value in opinion shopping.
- 15) What effect would a rotation requirement have on competition for audit engagements? If competition would be increased, how might that affect audit quality?

- * Increased competition will raise the auditing standards as no firm can become an entrenched incumbent. It should provide more opportunities for the mid-size public accounting firms, lowering the cost of audits and providing greater independence and objectivity in the long term
- 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?
- * As noted above, I recommend that the QC function be taken out of the performing audit firm's control and given to an independent firm for improved transparency and value to the Board.
- 17) If the early years of an auditor-client relationship pose 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?
- * As noted above, audit fees have not been reduced as an audit firm gains experience in the client space, so that begs the question as to whether the firms truly provide additional supervision in the early years of an engagement.
 - * The Board is responsible for the selection of the external auditor. They should have a clear due diligence procedure that provides reasonable assurance that they are able to select an audit firm that meets the shareholder needs
- 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?
- * Recommendation that the successor auditor have reasonable (not unlimited) access to the prior auditor's work papers to provide transparency and allow for audit-to-audit discussion as to concerns and issues
- 19) Are there other audit procedures that should be required to mitigate any risks posed by rotation?
- * No comment relative to other audit procedures
- 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?
- * Leave the current rules in place, providing a firm with the flexibility to replace an audit firm for board-identified cause
 - * In the case of significant scope expansion due to acquisition, the audit firm should have the right to withdraw from the engagement due to either a lack of capacity or capability
- 21) What other transition issues might arise in the first year of a rotation requirement? How should the Board address these issues?
- * No further recommendations

I appreciate the PCAOB's time in reading through my comments. As noted. Should more information be required, please feel free to contact me at your earliest convenience.

Sincerely,

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