



December 8, 2011

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, DC 20006-2803

**RE: Concept Release on Auditor Independence and Audit Firm Rotation,
PCAOB Rulemaking Docket Matter No. 37**

Dear Office of the Secretary:

CarMax, Inc. ("CarMax") is pleased to submit comments on the Public Company Accounting Oversight Board's ("PCAOB" or the "Board") concept release on auditor independence and audit firm rotation (the "Release").

CarMax is the nation's largest retailer of used vehicles and a member of the Fortune 500 and S&P 500. Headquartered in Richmond, Virginia, CarMax currently operates 107 used car superstores in 52 markets.

The Sarbanes-Oxley Act of 2002 (the "Act") included a significant number of provisions that were designed to improve auditor independence, and we support the Board's initiative to continue to improve audit quality and strengthen auditor independence, especially as it relates to professional skepticism. However, we do not believe mandatory audit firm rotation is the appropriate avenue by which to achieve the desired improvements. Instead, we would encourage the Board to consider providing audit committees with additional and more timely information regarding inspection activities and results with respect to the company's auditor.

We believe the costs and risks associated with audit firm rotation, both to the company being audited and its stakeholders, significantly outweigh any benefits that may be gained by the perceived increases in independence, objectivity and professional skepticism. Audit failure is a function of a lack of audit quality, and while audit quality *may* be impaired by a perceived lack of independence, we are not aware of any evidence that it is the root cause of any audit failures.

In this letter, we have provided specific comments that we believe will enhance the Board's understanding of the issues related to mandatory audit firm rotation and our belief that such mandatory rotations will not improve audit quality.

We would be pleased to discuss our comments with members of the Board or its staff. Please feel free to contact me at (804) 747-0422.

Sincerely,

A handwritten signature in black ink, appearing to read "TWR", written over a light blue rectangular background.

Thomas W. Reedy, Senior Vice President and Chief Financial Officer
CarMax, Inc.

As noted in the Release, the Board is seeking comments on all aspects of the issues discussed in the Release. However, preliminarily, the Board seems most interested in views on several general issues. Accordingly, we have considered our position on the Release in the context of these issues and provided our responses accordingly – the Board’s questions that we have addressed are included below in bold and italics with our responses following.

Should the Board focus on enhancing auditor independence, objectivity and professional skepticism? How significant are the problems in those areas relative to problems in other areas on which the Board might focus? Should the Board simply defer consideration of any proposals to enhance auditor independence, objectivity and professional skepticism?

We believe it is inherent in the oversight role of the PCAOB to continually strive to enhance auditor independence, objectivity and professional skepticism, but these characteristics of an independent auditor are simply a subset of overall audit quality. While these are each individually important characteristics, we would contend that audit quality is the overarching concept that warrants the Board’s attention, but not before determining whether there is sufficient evidence to indicate that there are widespread audit quality issues.

Would audit firm rotation enhance auditor independence, objectivity and professional skepticism?

No, we do not believe that requiring a company to rotate its external auditor will create or enhance independence, objectivity or professional skepticism. Overall, the auditor/client relationship is one between individuals, not companies or audit firms. Therefore, unless the individual auditor has an attitude of appropriate professional skepticism and has the technical knowledge to complete the audit, an audit failure is a possibility whether or not they are subject to a mandatory rotation requirement.

This position is consistent with the conclusions reached by the multiple studies and government agencies discussed in the Release, such as the 2003 report from the General Accounting Office (“GAO”). While we agree with the Board that it is critical to continue to challenge current methodologies and strive for excellence, we do not believe there is significant evidence to alter these earlier conclusions. Therefore, it would be unwarranted to place further regulation on public accounting firms and additional burden on public companies with no clear indication that this would improve audit quality.

What are the advantages and disadvantages of mandatory rotation? If there are potential disadvantages or unintended consequences, are there ways a rotation requirement could be structured to avoid or minimize them?

While the Release suggests that there are some advantages to mandatory rotation, we believe the disadvantages far outweigh any perceived advantages.

Perceived Advantages

Two perceived advantages of mandatory rotation addressed by the Release are (1) a different perspective on issues at a company, or a “fresh set of eyes,” and (2) an increase in professional skepticism.

(1) *Different perspective*

We believe that a different perspective may bring new insight to the audit of a company and may uncover issues or risks that had not been previously explored. However, mandatory rotation is not required to yield the Board's desired results. In fact, we recently underwent the rotation of the partner on our audit, as required by the Act. While this rotation required additional time and effort by both the company and the auditor and created a lack of continuity, the different perspective from our new partner illustrated that our current audit firm consistently displays the appropriate level of independence, objectivity and professional skepticism, and that mandatory firm rotation is not necessary to effectively obtain a different perspective.

(2) *Professional skepticism*

AU Section 230 of the AICPA's Auditing Standards Board's *Statement on Auditing Standards* describes professional skepticism as "an attitude that includes a questioning mind and a critical assessment of audit evidence." This *attitude* encompasses primarily two concepts: (1) in the process of gathering and objectively evaluating audit evidence the auditor must consider the competency and sufficiency of the evidence; and (2) the auditor should not be satisfied with less than persuasive evidence because of a belief that management is honest.

We concur with the Board's position that professional skepticism is critical in the performance of quality audits. If it is the Board's position that a strong relationship between the auditor and the client may have a negative perception in the eyes of the public, it may appear to the public that mandatory rotation would increase professional skepticism. This is primarily based on the premise that while the successor auditor will not automatically assume that management is dishonest, they are less inclined than the predecessor auditor to assume unquestioned honesty when evaluating the sufficiency of evidence provided. However, as discussed below, this would likely only be an increase in the appearance of professional skepticism, but would not be a true increase if properly considering the aforementioned concepts.

Disadvantages

As previously discussed, we believe the disadvantages of mandatory rotation are numerous and greatly outweigh any perceived advantages. These disadvantages can be broken into four primary categories – (1) an increase in professional skepticism is only in appearance, not in fact; (2) a decrease in audit quality; (3) interference with corporate decision-making, governance and customer service; and (4) cost.

(1) *Increase in professional skepticism is only in appearance, not in fact*

Though changing audit firms may give the impression of an increase in professional skepticism or independence, we contend that the apparent increase is merely due to lack of knowledge. If an auditor has limited knowledge of a company's business, core processes and key risks, it would be difficult to appropriately apply professional skepticism. Instead, information may be questioned by the auditor, in general, without applying the appropriate consideration to reasonableness or risk.

We believe this lack of knowledge would severely inhibit the auditor's ability to adequately "consider the competency and sufficiency of the evidence" that is being

gathered and must be objectively evaluated during the audit, which is a cornerstone of professional skepticism. As a result, they may have difficulty effectively assessing significant areas of risk and could potentially overlook material unusual items. These are indicators that the apparent increase in professional skepticism may actually mask a fundamental decrease in audit quality.

Our position is that auditors can apply professional skepticism more effectively when they have an in-depth understanding of the business and management's incentives and pressures, thus allowing them to appropriately challenge information that does not appear reasonable and evaluate the adequacy of any objective evidence provided.

(2) *Decrease in audit quality*

Learning curve. The first few years of a new audit relationship can be challenging, primarily due to the auditor's lack of knowledge about the company's business and the general relationship-building process. While there are likely many professionals within every audit firm who have a strong understanding of specific industries, each company still has intricacies, strengths and limitations that can best be understood after a significant amount of time and effort has been invested by both the company and the audit firm.

We believe key elements of audit quality are the technical expertise of the audit firm and its ability to apply that expertise in order to exercise appropriate professional skepticism, evaluate risks, and develop and execute an effective audit plan. Therefore, if this learning curve is one that must be overcome frequently due to a mandatory rotation requirement, audit quality will suffer.

Industry expertise. In addition to the knowledge vacuum that is created during a rotation of audit firms, a mandatory rotation requirement also has the potential to limit the quality and technical expertise of audit firm personnel who are performing the audits. As CarMax is a unique retailer headquartered in a relatively small metropolitan market, we believe this could compromise our ability to consistently retain an audit firm with the appropriate technical expertise.

Non-audit services. Mandatory rotation may also result in a decrease in independence, objectivity and professional skepticism. In many cases, non-audit services are more lucrative than audit services. Therefore, in the absence of specific restrictions, some audit firms may see an impending rotation as a prime opportunity to cultivate relationships with a company they see as a future target for non-audit services.

(3) *Corporate decision-making, governance and customer service*

Decision-making. We believe accounting ramifications should not be a deciding factor in making the best business decisions for our customers and our shareholders. However, a mandatory rotation requirement could put companies at a competitive disadvantage in the year of or the year following a rotation by making it more difficult to successfully complete a significant or complex business transaction (e.g., a material business acquisition) and/or to comply with SEC reporting requirements while undergoing a change in auditors.

We do not believe a company should have to consider a change in auditors when making such decisions about the business and conducting strategic planning for the future; however, this type of “planning around rotation” would be inevitable in a mandatory rotation environment. In addition, it would be difficult for the new firm to adequately evaluate complex accounting issues if they have limited knowledge of the core business or the industry, and therefore, could expose the company and the auditor to additional risks.

Corporate governance. In addition to impacting corporate decision-making, a mandatory rotation requirement would also impact the role of our Audit Committee in governing the audit process. We believe our Audit Committee is in the best position to oversee the audit and select an audit firm that meets the needs of the company. A mandatory rotation requirement may inhibit their oversight role and their ability to respond to concerns appropriately because the availability of a suitable replacement auditor may be limited due to the new regulations and existing relationships with other audit firms.

Customer service. Customer service is another matter that could be compromised by mandatory rotation. When we pay a firm for audit services, we believe we are paying for a service, not a commodity. As part of the audit, we expect an appropriate level of customer service, and in a mandatory rotation environment, there would be little incentive for audit firms to provide a high level of service, except where there is the future potential for gaining lucrative non-audit services.

To be clear, a high level of service does not imply a lack of objectivity and professional skepticism or leniency on accounting conclusions. Instead, we believe a high level of service is evidenced by a view of the audit as a continuous process, not merely a series of required quarterly and annual procedures; appropriate consultation on complex issues or transactions, and if necessary, escalating them to senior levels within the audit firm; timely responses to questions and issues; and clear communication about the audit plan and audit progress. With a likely decrease in organizational knowledge, the loss of technical expertise within audit firms and the increased cost of performing audits due to an ongoing learning curve, we fear that customer service will suffer with mandatory rotation.

(4) *Cost*

We believe the increase in costs would outweigh any perceived benefits of rotation.

Increased audit fees. One cost increase related to mandatory rotation includes additional fees charged by audit firms in the early years of an audit. In the current environment, audit firms may be willing to accept lower profitability in the early years of an audit as a way of investing in a longer-term relationship. In a mandatory rotation environment, the audit firms would have no incentive to absorb or even share in some of the initial audit start-up costs, as there would be no long-term relationship with the company.

In addition to increased fees in the early years of the audit relationship, we also believe the company would have less ability to negotiate fees with the auditor. In longer relationships, it is possible for the audit firm and the company to work together to identify opportunities to improve audit efficiency and reduce overall effort while

maintaining quality, which in turn, can result in reduced audit fees. A short-term relationship would not provide sufficient time to develop such efficiencies, and there would be little incentive for the audit firm to invest time in evaluating these potential fee reductions because the client would soon be lost to another audit firm.

Finally, healthy competition among the audit firms has helped to maintain lower audit fees following the severe spike in audit costs associated with implementing the new requirements of the Act. For large public companies, the market for preferable audit firms is often already limited to the “Big 4” public accounting firms. Mandatory rotation would further reduce the options and reduce the level of competition among firms.

Increase in internal resource utilization. Outside of tangible audit fee increases, we also expect that companies would experience a significant increase in internal costs with mandatory rotation. A significant amount of time is spent throughout an organization educating a new audit firm about the intricacies of the business as well as ensuring the company is appropriately responding to all auditor requests, which will vary from one auditor to the next. While CarMax has not experienced a change in audit firms, we do have some insight into the cost and effort it would entail through the partner rotation process and general audit staff turnover. While these changes would not rise to the significance of an audit firm rotation, they do create a lack of continuity that has to be addressed to ensure our audit is completed in a quality manner.

Because there appears to be little or no relevant empirical data directly on mandatory rotation available, should the Board conduct a pilot program so that mandatory rotation of registered public accounting firms could be further studied before the Board determines whether to consider developing a more permanent requirement?

We do not believe a pilot program is the best way to study this potential change, even though it would be difficult to make a determination about the effects of a permanent requirement for mandatory rotation without additional direct evidence.

Creating a pilot program would unfairly target certain businesses and place them at a competitive disadvantage because of the requirement that they rotate audit firms. If the Board selected participants in the pilot program without input from the companies and their audit committees, they could be disrupting critical business decisions or transactions that may be difficult to complete in the midst of a change in auditors. On the other hand, if the Board chose participants based on specific risk factors or used volunteers for the program, we do not believe this would provide a fair representation of how the program may ultimately work in the larger population of all public companies. Voluntary participants may have been interested in changing auditors before the pilot program and simply use the pilot program to effect that change without arousing suspicion or needing to provide an explanation for the change, while companies specifically selected by the Board may not fit the risk profile of typical public company auditees.

Additionally, the scrutiny placed on the companies in the pilot program and their auditors would almost guarantee that audits performed within the pilot program would provide a higher level of documentation of independence, objectivity and professional skepticism than that which one would normally see in a typical audit of a public company. When a public accounting firm anticipates that their work will be reviewed in detail by the Board, their appearance of

independence, objectivity and professional skepticism may be heightened. While we do not necessarily believe these audits would be of a higher quality, we do believe audits conducted with the knowledge that the related documentation will be scrutinized by the Board will have a higher standard of documenting such factors and would not likely be representative of all audits performed under mandatory rotation.

According to the 2003 GAO Report, large firms estimated that a rotation requirement would increase initial year audit costs by more than 20 percent. What effect would a rotation requirement have on audit costs? Are there other costs the Board should consider, such as the potential time and disruption impact on company financial reporting staff as a result of a change in auditors?

Effect on audit costs. As discussed previously, the increase in audit costs would encompass multiple factors. First, there would be an increase in the time and effort required by the audit firm to gain a baseline understanding of the company, evaluate risks and develop an initial audit strategy. Second, because the firm would know in advance that they are going to lose this client after a specified interval, they may be less likely to absorb some or all of the start-up costs for fear of being unable to recover these costs over the course of the contract period. Finally, firms would be less inclined to negotiate fees with a client with whom they were not going to have a long-term relationship.

Other costs. As discussed previously, there is a significant increase in internal resource utilization associated with the change in auditors. Educating a new firm and becoming familiar with that firm's audit methodology can be time consuming and would impact multiple levels and departments within the organization, not just the company's financial reporting staff. For a large public company, the audit process is often decentralized, where the auditors interact directly with individuals or departments throughout the organization, as needed. As the organization grows and becomes more complex, this impact would become even more pervasive.

To what extent have audit committees considered implementing a policy of audit firm rotation? Could audit committee oversight of the engagement be otherwise enhanced in a way that meaningfully improves auditor independence?

Our Audit Committee's activities are, in part, governed by its Charter, which does contemplate audit firm rotation, where it states the following:

“In connection with its evaluation of the independent auditor, the Committee should, in addition to assuring the regular rotation of the lead audit partner as required by law, consider whether, in order to assure continuing auditor independence, there should be regular rotation of the independent audit firm itself.”

We believe our Audit Committee effectively executes their responsibility for governing the audit process. However, we would encourage the Board to consider providing audit committees with additional and more timely information regarding inspection activities and results with respect to the company's auditor. This approach would limit the impact of new regulations on companies and audit firms, but would give audit committees a broader perspective when carrying out their oversight responsibilities.

Should the Board continue to seek to address its concerns about independence, objectivity and professional skepticism through its current inspection program?

Yes, we agree that the Board should continue to seek to address its concerns through its current inspection program. As noted in the Release, the Board's past inspection experience, in general, has highlighted valid concerns related to the specific audit firms and audit engagements that were subject to inspection. However, the manner in which audit firms and audit engagements are selected for inspection makes it difficult to extrapolate the results across the entire population of audits, which hampers any attempts to draw valid conclusions on the overall state of auditor independence, objectivity and professional skepticism.

Even when considering the Board's inspection results to date, we are not aware of any direct linkage that has been made between audit quality and the auditor's tenure. As stated in the Release, "[p]reliminary analysis of [those results] appears to show no correlation between auditor tenure and number of comments in PCAOB inspection reports." This further illustrates that while the results to date have uncovered valid concerns surrounding audit quality, there is currently not enough information to determine that the issues are pervasive enough to warrant such a far-reaching proposal or to suggest that mandatory rotation will yield the desired improvements.