



December 12, 2011

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

Rulemaking Docket No. 37

The American Gas Association (AGA) respectfully submits comments on the Public Company Accounting Oversight Board's (PCAOB) *Concept Release on "Auditor Independence & Audit Firm Rotation"* (the "Release"). The AGA, founded in 1918, represents 201 local energy companies that deliver clean natural gas throughout the United States. There are more than 70 million residential, commercial and industrial natural gas customers in the U.S., of which 91 percent — more than 64 million customers — receive their gas from AGA members. AGA is an advocate for natural gas utility companies and their customers and provides a broad range of programs and services for member natural gas pipelines, marketers, gatherers, international natural gas companies and industry associates. Today, natural gas meets almost one-fourth of the United States' energy needs.

Summary

We welcome the chance to offer our views on ways to enhance auditor independence, objectivity and professional skepticism, which are central to the role that auditors play in our financial system. While we understand the PCAOB is seeking views on both mandatory audit firm rotation and possible alternative methods to achieve the above objectives, it is clear from the content of the release and related public statements that mandatory rotation is the only method which has thus far received any significant degree of attention. Further, while enhancing the qualitative characteristics above is a noble goal, any significant steps toward that aim ought to be cast in the primary light of whether audit quality will be significantly enhanced, at what cost, and importantly, whether the quality of related financial information provided to investors will be significantly improved as a result.

We do not believe that mandatory audit firm rotation is the most cost-beneficial method to achieve these objectives, for reasons more fully explained below. Further, any significant changes that may be undertaken going forward ought to be deliberated within a more full discussion and analysis of the significant changes arising from passage of the Sarbanes-Oxley Act (SOX), including enhanced requirements related to audit committee responsibilities, restrictions imposed on audit firms, and related impacts on audit quality and the quality of reported financial information.

Current State of Auditor Independence & Objectivity

During the PCAOB open meeting to approve the Concept Release, PCAOB Board members and staff discussed ongoing research by the staff to analyze whether audit deficiencies identified by the staff through the inspections process could be tied to a lack of professional skepticism, independence, and objectivity. It was acknowledged that the PCAOB's research thus far was inconclusive; however, it was also noted that the research was not yet complete. Further, the Concept Release acknowledges that not all audit deficiencies detected by the PCAOB inspection staff necessarily result from a lack of objectivity or professional skepticism, but rather could "reflect a lack of technical competence or experience, which may be exacerbated by staffing pressures or some other problem." Additionally, the Concept Release notes that because the Board's inspection program is risk-based, it may be looking at "the most error-prone situations." We believe it would be helpful for the PCAOB to complete its analysis and further specify its fundamental concerns, including how or whether those concerns have actually resulted in reduced quality of reported financial information that would be considered important to investors. We believe any comments made by constituents on a proposed change as substantial and potentially costly as mandatory audit firm rotation (or possible alternative approaches) would be most helpful after having clarified those fundamental issues and fully researched their root causes.

As noted above, we support the enhancement of auditor independence, objectivity and professional skepticism. Before addressing whether significant further enhancements are warranted, it would make sense to evaluate the current state of these characteristics within the audit profession. The Securities and Exchange Commission ("SEC") and PCAOB both maintain standards on auditor independence, objectivity, and professional skepticism, including:

- Auditor communications with audit committees regarding independence;
- Prohibitions on hiring former auditors, including cooling-off periods; and
- Prohibitions on the types of services auditors can provide, including providing tax services to those in financial reporting oversight roles

Further, existing rules requiring partner rotation as a result of SOX and the effects of PCAOB oversight of external auditors serves (in concept) to encourage these characteristics. Finally, the passage of SOX has had a significant effect on the role of the audit committee, including a requirement to review the independence and qualifications of auditors prior to retaining the auditor and their responsibility to pre-approve all audit and non-audit services provided by the auditor. While there may be some enhancements that could provide incrementally beneficial value (beyond mandatory firm rotation as discussed below), our member companies generally believe that these existing requirements serve to encourage sufficient auditor independence, objectivity, and professional skepticism and that as a result, the quality of public company-reported financial information is generally useful, relevant, and reliable for decision-making purposes.

We do believe that if the PCAOB decides to undertake further investigation into ways to improve auditor independence, objectivity and skepticism, it would be better that it does so in a comprehensive manner. For example, the PCAOB may consider reevaluating the current status of existing auditing standards maintained by the PCAOB and SEC covering these concepts, which we understand to have been largely carried forward unmodified since their previous issuance by the AICPA.

Mandatory Firm Rotation

It is our belief that any significant change undertaken to enhance auditor independence, objectivity, and skepticism be done in light of whether significant improvements to audit quality and therefore reported financial information will occur. In the view of our member companies, mandating audit firm rotation has the very real and likely risk of actually detracting from these ultimate objectives. We offer the following reasons, which we expect will have been stated before but nonetheless bear repeating.

- Mandatory rotation removes the knowledge base and understanding developed by the audit firm, which threatens audit quality and effectiveness. Performing a high quality, effective audit depends on an auditor's detailed understanding of an entity's operations. This is particularly important for industries such as ours which are highly regulated and specialized in terms of the services and products we offer, related business processes and risk, etc. This knowledge is only truly developed over time and experience.
- Audit firm rotation may actually discourage the accumulation of sector/industry specific expertise. As noted above, expertise in a specific industry or sector is a key contributor to audit quality, particularly in those which are highly technical or regulated, requiring a deep base of knowledge to execute an effective audit. Deep industry/sector expertise cannot be supported without a critical mass of audit engagements in the given industry/sector. While audit firms may be able to perform an adequate audit absent such a base, requiring mandatory rotation would inevitably introduce risk and, at best, "normalize" what are today deep concentrations of expertise within certain industries (including ours).

In addition to the above potentially negative effects on audit quality, multiple practical challenges may exist as a result of mandating firm rotation, including:

- It may be extremely difficult for a firm to assign appropriate resources each time a firm rotates, particularly in the context of auditing large companies with multiple geographic locations and/or in the context of auditing specialized industries. Managing resources so that sufficiently experienced professionals are available each time a firm rotates may be difficult.
- Large companies may use multiple firms for audit and non-audit services; their choice will certainly be limited in a mandatory rotation scenario. In fact, they may have to sacrifice needed advisory services in order to comply with such requirements.

- Mandatory rotation may be disruptive or cause conflict within a company's financial events and capital markets activities (i.e., corporate financings, M&A transactions, restructurings, etc.).

Lastly, while we believe any perceived benefits arising from mandatory rotation to be conjectural, if required they will most certainly come with a cost; a cost we do not believe justifies such a requirement. For example:

- For every rotation, management will face the disruption, expense, and time involved in changing its audit firm. Management may devote hundreds, and sometimes thousands, of hours in helping the auditor understand the company (in addition to the time spent evaluating and selecting the auditor upfront).
- Because the proposal/audit tender process diverts attention from performing audits, audit fees would likely have to be raised to cover additional resources needed by the audit firm to maintain audit quality. There are numerous other reasons why audit fees would likely increase, including the "fixed costs" associated with audit opening balances and earlier transactions, the incentive to "over audit" in early audit years given lack of ongoing experience with a given client or industry that is new to a firm, etc.
- The current incentives for audit firms to offer lower fees in earlier audit years in order to maintain a longer term client relationship or develop a particular industry or geographic expertise will evaporate. These additional costs will in all likelihood be passed onto the entities being audited. Finally, these rising costs are not likely to be a "zero-sum" game where some companies or industries save and others overpay; all audit firms will be facing the same risks and pressures, resulting in potential "system-wide" increases in audit costs to the companies and industries being audited.

Alternative Approaches

While we are not convinced that enhancements to auditor independence, objectivity and professional skepticism are required, we offer the following thoughts on possible alternative approaches to mandatory audit firm rotation that may be considered. Unless specifically noted, we are not suggesting that such alternatives necessarily need to be implemented. These alternatives primarily focus on the audit committee's role and the PCAOB's reviews of auditors' work.

As discussed above, SOX resulted in additional responsibilities being placed on audit committees and it is part of the audit committee's role to appoint and monitor the activities of the independent auditor. Based on our experience, members felt that audit committees take this responsibility very seriously and actively engage with the audit teams and thoroughly review their reports. If further enhancement of this process is considered necessary, further guidelines (or requirements) could be provided to audit committees encouraging periodic formal processes to determine whether a change in auditor should be made (request-for-proposal processes). Further, we are aware that there has been consideration by some affected constituents of the current composition of audit committees and the type of financial or accounting expertise

represented. If there are concerns about the ability of the audit committee to perform its auditor oversight role, these discussions could be revisited.

In the Release, it was stated that there have been instances in PCAOB inspections where evidence of a bias towards supporting management's position was identified, as well as proposal materials that indicated a willingness on the part of the auditor to partner with management that appears at odds with applying professional skepticism. The PCAOB review procedures could be enhanced to focus on identifying within audits where appropriate skepticism is not evidenced and these areas could be emphasized in inspection reports.

Additionally, one alternative that we specifically endorse would be timely disclosure of all PCAOB inspection findings to the respective audit committees of individually inspected company audits. This may serve as an incentive to auditors to more strictly adhere to audit standards, and would also provide audit committees with direct insight into the quality with which their company's audits are performed. The PCAOB may also consider requiring public disclosure of all inspection findings related to a particular audit firm, although this would represent very significant change from the current process that would require further analysis and discussion. This approach would provide additional information to companies, audit committees, and the user community about areas where audit quality or other audit issues were identified and provide a forum for audit firms to indicate how those areas are addressed.

Conclusion

We appreciate your consideration of this issue and our comments. While we support enhancements of the attributes of auditor independence, objectivity and professional skepticism, we feel that costs incurred to support those enhancements must be justified by the benefits. We do not believe that mandatory audit firm rotation would provide sufficient benefit to overcome the significant cost and operational issues it would create. The changes to audit committee responsibilities and auditor requirements mandated by SOX (including mandatory partner rotation, audit committee communications and prohibition on performing certain non-audit activities) are sufficient in our view at this time to ensure that the attributes of independence, objectivity and professional skepticism are appropriately applied in performing audits. To the extent issues are identified in PCAOB inspections, the enforcement actions available to the PCAOB appear sufficient to address them.

Very truly yours,

Jose Simon [s]

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