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Office of the Secretary
PCAOB
1666 K Street, NW
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Submitted via electronic mail

Re: PCAOB Release No. 2011-006, PCAOB Rulemaking Docket Matter No. 37

Wells Fargo & Company (Wells Fargo) is a diversified financial services company with over \$1.3 trillion in assets providing banking, insurance, investments, mortgage and consumer finance services. We appreciate the opportunity to comment on the *Concept Release on Auditor Independence and Audit Firm Rotation* (the “Concept Release”).

Executive Summary

We agree that auditor independence is critical to ensuring audit quality. However, we also believe that existing professional standards and practices, including the additional safeguards established pursuant to the Sarbanes Oxley Act of 2002 (“SOX”), already effectively ensure that auditors remain independent in both fact and appearance. While the intentions of the PCAOB proposal to promote and improve audit quality are laudable, we do not believe there is sufficient evidence to support the underlying assertion that a lack of auditor independence is a pervasive problem or a primary cause of audit failures. Audit inspections performed by the PCAOB have not yielded a significant number of deficient audits, nor has the PCAOB identified any correlation between audit failures and a lack of auditor independence.

Mandatory auditor term limits will increase audit risk, subject reporting entities to substantial incremental costs, further narrow the field and create conflicts of interest among potential replacement audit firms, and limit competition due to concentrations of industry expertise and geographical reach. For these reasons, we do not believe there is a reasonable basis to mandate term limits for auditors as a solution to a perceived but nonexistent problem.

Specific Comments on the Concept Release

Our specific comments on the Concept Release are as follows:

- There is a lack of sufficient evidence that mandatory auditor term limits will enhance auditor independence: Mandatory auditor rotation has been frequently studied and debated in the past by the accounting profession, legislators and the SEC, ultimately culminating in the issuance of the GAO

Report in 2003¹. The GAO rejected mandatory audit firm rotation, citing the substantial incremental financial costs, loss of institutional knowledge of the incumbent auditor, and reforms that would be implemented under SOX as a basis for its conclusion. The GAO qualified its conclusion, however, stating that several years would be required to assess the effectiveness of the SOX reforms.

Now, several years after the implementation of SOX, PCAOB inspection activities strongly validate the conclusion in the GAO Report. PCAOB inspection activities, which target audits that are arguably most susceptible to failure due to a lack of auditor independence, have not indicated a correlation between auditor tenure and audit failures. In fact, the PCAOB appears to believe that overall audit quality has improved since the issuance of the GAO report. Likewise, the academic studies cited in the Concept Release fail to support the presumption that audit firm rotation would enhance auditor independence as many of these studies support the opposite conclusion that audits with short tenure are relatively riskier.

We do not understand why the PCAOB is an advocate for mandatory auditor rotation given the weight of empirical evidence against it. Instead, it appears, in order to bolster the case for auditor term limits, the PCAOB is giving precedence to anecdotal evidence. If the PCAOB believes further enhancements to auditor independence requirements are necessary to improve audit quality, it is imperative that the root causes of audit failures are studied more thoroughly, either directly by the PCAOB or by another accredited research group, before auditor term limits are established.

- There are already comprehensive quality control measures that ensure and enhance auditor independence: Audit firms are subject to onerous internal and external quality control measures, including measures enacted under SOX to improve auditor independence. One of the most significant SOX enhancements included the creation of the PCAOB and the PCAOB inspection program (a program which has not identified the existence of a pervasive lack of auditor independence or professional skepticism). The PCAOB also issued Auditing Standards No. 7, *Engagement Quality Review* (“AS7”), to strengthen the criteria for audit engagement partner review requirements. Although only first effective for the fiscal 2010 audits, AS7 is expected to enhance audit quality and strengthen auditor objectivity. As a public registrant, we have directly experienced the effectiveness of these enhancements as our auditors have adapted their audit procedures as a result of feedback from the PCAOB.

Annual audit committee communications also play an important role in maintaining auditor independence. Such communications require the communication of all relationships between the audit firm and its client, a description of the audit firm’s quality control procedures, and material findings from peer or internal reviews and PCAOB inspection activities. Still, other rules place limitations on client hiring of certain audit firm personnel, prohibit the performance of certain non-audit services and limit the tenure of the audit engagement partners.

Meaningful disincentives already exist to ensure audit quality control measures are adhered to. For example, potential audit failures may be signaled in public SEC filings that require registrants to describe disagreements with their auditors or notify a change in auditors. In addition, poor PCAOB inspection or peer review results may result in the assessment of financial penalties and employment

¹ United States General Accounting Office Report to the Senate Committee on Banking, Housing, and Urban Affairs and the House Committee on Financial Services, *Public Accounting Firms: Required Study on the Potential Effects of Mandatory Audit Firm Rotation*

actions, including termination, while audit failures may be accompanied by even more severe sanctions, such as civil or criminal penalties. Accordingly, it is not reasonable to assume incumbent auditors would audit any more rigorously simply because they would be subject to mandatory rotation. Given the comprehensive scope and nature of existing quality control measures, including disincentives for non-compliance, we question why it is necessary to penalize all registrants with mandatory limitations on auditor tenure.

- **Mandatory auditor rotation is simply not practical:** Given the scale and complexity of audits required for many companies, there is a practical limit to the number of viable audit firm candidates. Large, complex, multi-national companies are realistically limited to using of one of the Big 4 accounting firms. However, given that financial institutions operate in complex market environments and pose unique challenges from both operational and technical accounting perspectives, we believe only two of the Big 4 accounting firms represent viable candidates for our company. More broadly, specialized industry and geographical expertise and resource capability would be difficult to obtain in a timely manner. In order to acquire appropriate resources and industry expertise, firms would likely need to hire resources from the incumbent audit firm, thus counteracting the perceived benefits of mandatory rotation while “bidding up” the cost of industry audit expertise.

The field of viable audit firm candidates is also limited by existing rules meant to enhance auditor independence by prohibiting the performance of certain non-audit services, a portion of which is typically divided among the remaining Big 4 firms. Frequently, non-audit services represent significant, complex multi-year projects. It is simply not feasible to expect that such projects could be completed or transferred to a replacement firm in a timely manner, particularly since such projects would need to be completed or transferred at least 12 months in advance of a rotation in order to satisfy existing independence requirements of the replacement audit firm and facilitate planning of the audit. Other unintended consequences that adversely impact audit quality may materialize. For example, when the field of potential service providers is limited due to specialized industry knowledge or geographic resource capabilities, companies may have no choice but to award either audit or non-audit services to less qualified firms.

Given these challenges, we are concerned that many large and complex multi-national companies will be unable to retain a qualified audit firm if mandatory auditor rotation is required. Mandatory auditor rotation simply replaces a perceived audit risk with a tangible and more serious audit risk as the challenges posed by mandatory auditor rotation would severely damage audit quality for several years subsequent to a rotation.

- **The audit committee is best qualified to determine when external auditors should be replaced:** We acknowledge that there was some historical concern regarding the effectiveness of some audit committees. However, such concerns were significantly ameliorated as a direct result of the quality control enhancements enacted through SOX. In particular, the responsibility for the appointment, compensation and oversight of auditors was granted to the audit committee, which complements the audit committee’s responsibility for oversight over the financial reporting process and internal control environment. Audit committees hold regular executive sessions and day-to-day meetings with management and external auditors to gauge the effectiveness of management, the internal control environment, the quality of the audit and management’s relationship with the auditors. Accordingly, determining when a change in the external auditor is necessary is a fundamental responsibility of the audit committee. Mandatory auditor rotation would undermine the judgment of the audit committee and unduly weaken the effectiveness of its oversight responsibilities.

- Mandatory auditor rotation would be costly and disruptive: Mandatory auditor rotation would subject companies to significant costs. The GAO Report indicates that initial year audit costs could increase by 20%. However, this figure does not contemplate the incremental costs associated with reporting requirements imposed by post SOX legislation and regulations such as the Dodd-Frank Wall Street Reform and Consumer Protection Act. It is also likely that the GAO estimate does not contemplate the leverage that certain audit firms would have in setting fees if, as discussed above, there are a limited number of viable replacement audit firm candidates. Other costs that need to be considered include the “shadow” audit costs of the replacement firm during the final year of an audit engagement, as well as ongoing fees due to the incumbent auditor related to assistance provided in the year of transition and previously audited financial statements, such as consents to include the incumbent firm’s audit opinion in registration statements. There are also unquantifiable costs related to audit detection risk in the years after a rotation.

While the PCAOB acknowledges that mandatory auditor rotation would “risk significant cost and disruption”, it is troublesome that the PCAOB has not performed a meaningful study of these costs or their impacts. We believe that the PCAOB should first determine whether there is any meaningful benefit to mandatory auditor rotation coupled with a formal cost and impact assessment to determine if such costs are justified.

- If the PCAOB decides to pursue mandatory auditor rotation, it should not be limited to large company audits: Small companies are typically audited by smaller firms and, on a relative basis, likely represent large clients of smaller firms. Accordingly, smaller firms may be vulnerable economically to the loss of ongoing audit fees due to a disproportionate concentration of audit fees in fewer clients. Conversely, larger accounting firms with significant revenue streams are better able to withstand the loss of a large client. In addition to these economic pressures, auditor objectivity could be challenged by the inability of smaller firms to adequately rotate staffing resources due to a limited access to such resources. These examples illustrate that auditor independence is equally important for smaller audit engagements and we do not believe a scope exception should be provided for audits of small companies.

Recommendations to Consider

We believe there are opportunities to enhance audit quality and promote auditor objectivity that would be more effective and less disruptive than mandatory auditor rotation. Our recommendations are described below:

- Enhance required communications and information available to the audit committee: While we acknowledge that the PCAOB is currently unable to share the results of audit inspections with the audit committee, we encourage the PCAOB to work with the SEC and legislators to eliminate this restriction. Direct communication by the PCAOB would better enable audit committees to assess the effectiveness of the auditor and identify any potential concerns about the quality of the audit or objectivity of the auditor while alleviating any concerns regarding whether results of inspections are communicated transparently and objectively.

Additionally, we recommend that the PCAOB annually publish a report based on the results of its overall inspection program that is specifically tailored for use by audit committees. This report should include, at a minimum, general statistics about audit quality and a description of significant audit risks and deficiencies. We believe this type of information would improve the ability of the

audit committee to assess potential audit risks or concerns about auditor objectivity.

- The requirements for qualifying as a financial expert of the audit committee should be revisited: Currently, audit committee financial experts may not always have the requisite financial reporting experience to effectively perform the oversight responsibilities over the auditor relationship. We encourage the PCAOB to work with the SEC and legislators to ensure that “financial reporting experts” can assist the audit committee with the evaluation of complex financial reporting, accounting and audit matters, including independence issues. To supplement the capabilities of the financial reporting expert, we also recommend that the PCAOB consider minimum training requirements for these audit committee members related to auditor independence and related matters.
- Enhance auditor training requirements: To specifically address the audit quality concerns identified during PCAOB inspections, we recommend that the PCAOB provide a training program to inspected audit firms. Such a training program should provide audit firms with more definitive guidance related to areas of concern of the PCAOB, including specific examples of audit quality issues identified during the inspection process and perspective on appropriate responses to inspection findings. Additionally, the PCAOB should assess the adequacy of existing training programs at audit firms related to auditor independence, including appropriate emphasis on “professional skepticism” training. To the extent deficiencies are found, the PCAOB could provide recommendations on enhancements.

Conclusion

Existing safeguards provided by professional standards and practices and the oversight provided by the audit committee have been effective in ensuring and promoting auditor independence. We believe that mandatory term limits will adversely impact audit quality because such limits will increase audit risk, substantially increase costs, and limit the field of viable replacement audit firm candidates. We oppose mandatory auditor term limits and strongly encourage the PCAOB to review other alternatives to enhance audit quality and promote auditor objectivity, including enhancing communications and information provided to the audit committee, qualifications of the audit committee financial expert and auditor training requirements.

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Office of the Secretary

PCAOB

December 14, 2011

Page 6

We appreciate the opportunity to comment on the issues contained in the Concept Release. If you have any questions, please contact me at (415) 222-3119.

Sincerely,

/s/ Richard D. Levy

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cc: James Kroeker – Securities and Exchange Commission
Kathy Murphy – Office of the Comptroller of the Currency
Stephen Merriett – Federal Reserve Board
Robert Storch – Federal Deposit Insurance Corporation
Donna Fisher – American Bankers Association
David Wagner – The Clearing House Association