

Statement of  
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To the

Public Company Accounting Oversight Board

Regarding

Auditor Independence and Audit Firm Rotation

San Francisco, CA

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Chairman Doty, Board and Staff of the PCAOB

Thank you for the opportunity to comment on the Public Company Oversight Board's Concept Release on Auditor Independence and Audit Firm Rotation and its effort to enhance the independence, objectivity and professional skepticism of external auditors. And to express my personal view as to whether a decision to require the regular rotation of auditors would significantly further those efforts and is desirable.

I want to begin by expressing my respect and appreciation for the outstanding work of the PCAOB. A tribute to its committed and thoughtful leadership, its outstanding board members and superb staff. You are making a significant difference toward assuring auditor independence and audit quality.

I am impressed by the volume and quality of the responses you have received to your Concept Release. Rather than offering a comprehensive statement, I will focus my comments as a response to specific recurring arguments and will be happy to expand on them as you wish.

I recognize that many audit committees have been much more active and proactive in discharging their responsibilities under Sarbanes-Oxley. Certainly both the written and oral testimony before this body pays high tribute. I do not believe, however, the audit committee is capable of addressing the issues of lack of professional skepticism, bias, and lack of independence addressed by the Concept Release.

In reviewing the audit failures identified by the Board in its Concept Release, I am left with a question. Would a vigilant audit committee, discharging its responsibilities under Sarbanes-Oxley have discovered the lack of skepticism, bias, and lack of independence identified in the PCAOB audits? My belief is no. Not likely. Not systemically. If the relationship between management and auditors is harmonious, let alone cozy, how is the audit committee to effectively probe behind it? What questions could it ask and what consultants could it employ to get behind the harmonious responses it would receive from the management and the auditor that would have surfaced the conditions and failures identified in the Board audits. If there are instances where the audit committee has been successful in this regard it would be instructive if they could be made public.

How else to address the problem head on and not just at the margin? Short of, or as part of making mandatory rotation effective, I recommend the Board be empowered to publicly release the results of its investigations and proceedings and direct rotation of auditors where the investigation finds the absence of independence, objectivity and professional skepticism. Rotation could also be called for on other audits involving one or more of the same senior audit team members. Of course, action against the partner in charge of the audit team would have a meaningful impact. Rotation might also be called for in industries which appear to have a higher incidence of failure. The Board might consider responding to an audit committee request for an inspection but be careful about being overwhelmed by requests. I also recommend that the Board be enabled to reexamine what constitutes audit related consulting and define it more narrowly than the SEC has done.

I support mandatory rotation but I am not sanguine that it will produce the desired result.

To address recurring concerns raised about mandatory rotations. There may be, but not necessarily would be, costs associated with the rotation. I believe the concern is exaggerated and to the extent that there are costs, I believe they would be justified. I do not believe that the quality of the audit needs to deteriorate for the first year or two of the new auditor's work. The concern that audit quality might deteriorate in the last several years of the departing auditor's engagement casts serious doubt on confidence in its professionalism and suggests a more serious problem that I trust is not warranted. To what extent have these concerns manifest themselves in voluntary rotations? And, for reasons I have stated, I do not believe that such a requirement would reduce the authority and the role of audit committee.

The uncertainty I have is due to the international oligopoly of the Big 4 accounting firms. Auditing is a profession run as a business. As a business, oligopolies generally, recognizing their very comfortable and secure strengths, are not inclined to rock the boat in relation to each other. Status quo rather than competition is the name of the game. Would the auditing business behave any differently? What would it take for an auditor coming in to embarrass the one it is replacing: Certainly public policy would not look favorably at anything that jeopardizes the existence or even the reputation of one of the four.

On the other hand, mandatory rotation would, I believe, provide incentive to middle size firms to develop their capabilities to serve larger clients. This in turn, if successful, would enlarge and destabilize the oligopoly.

If mandatory rotation is undertaken, I recommend that it begin on a limited basis so that the Board and the firms can learn from the experience.

I close with the caution to the profession that what underlies this entire inquiry is the concern of many that its basic product – the reason that it has a statutory mandate – is suspect. If the profession doesn't see a problem and/or cannot be proactive in effectively addressing it, then perhaps the business model of the client/auditor relationship has to be changed.

I am happy to respond to questions.

